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## COMMISSIONED RESEARCH SERIES

# THE INFORMAL ECONOMY AS A PATH TO EXPANDING OPPORTUNITIES

Colin C Williams<sup>1</sup>

Paper prepared for the Centre for Development and Enterprise's Expanding Opportunities Project

August 2017

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<sup>1</sup> Colin Williams is Professor of Public Policy, Management School, Sheffield University



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## EXECUTIVE SUMMARY

Is the informal economy a help or a hindrance to expanding the opportunities of the poor? Conventionally, it has been deemed a hindrance; an unproductive sphere that is deleterious to wider economic development and growth. Recently, however, a more positive depiction has emerged viewing it as a useful means of expanding the opportunities of the poor. This report reviews the arguments and evidence for viewing it more positively and how it might be harnessed in order to help expand the opportunities of the poor.

### Defining the informal economy

Employment in the informal economy covers all persons employed either in the informal sector or in informal employment. By the informal sector is meant private unincorporated enterprises that are unregistered or small in terms of the number of employed persons. Informal employment, meanwhile, refers to jobs that lack basic social or legal protections or employment benefits and are found in the formal sector, informal sector or households.

### Prevalence of the informal economy

Globally, the majority of workers and enterprises operate in the informal economy. One recent analysis reveals that 59% of all new businesses in OECD countries start-up in the informal economy, 62.6% in transition economies, but 83.8% in Asia Pacific countries, 91.2% in Latin American and the Caribbean countries and 98% in African countries.<sup>2</sup> Similarly, 59.8% of non-agricultural workers globally have their main employment in the informal economy, although this again varies across global regions, ranging from 24.8% in Europe and Central Asia through to 75.6% in South East Asia.

Until now, the variations across countries in the prevalence of employment in the informal economy have been explained in three competing ways. A *modernisation thesis* dominated for most of the twentieth century which depicted employment in the informal economy as a relic from a pre-modern production era that would fade away as the modern formal economy took hold. In recent decades, however, the recognition that the informal economy is not disappearing has led to new explanations. On the one hand, an *agency-oriented* school of thought deems employment in the informal economy to be a rational economic decision taken in reaction to institutional conditions, such as high taxes, a corrupt state system and too much state interference, which leads workers to voluntarily exit work in the formal economy in order to avoid the costs, time and effort of formal registration. On the other hand, a *structuralist* perspective views employment in the informal economy as a direct by-product of the advent of a de-regulated open world economy, and as survival-driven employment conducted by marginalised populations excluded from formal jobs and formal welfare support who turn to the informal economy as a last resort. The informal economy from this perspective is thus higher in economies where there is inadequate state intervention to protect workers from poverty.

Evaluating these competing explanations, this report finds evidence to support the modernisation and structuralist theses that associate informality with under-development and inadequate state protection of workers from poverty respectively and the agency-oriented corruption thesis that informality is higher in countries where the perception of public sector corruption is greater. However, no evidence is found to support the validity of the agency-oriented theses that informality is associated with higher taxes and more state interference. Instead, as structuralist argue, higher taxes and more state intervention reduce informality, presumably due to the ability of governments not

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<sup>2</sup>Autio, E. & Fu, K. (2015). Economic and political institutions and entry into formal and informal entrepreneurship. *Asia Pacific Journal of Management*, 32(1), 67-94.

only to have efficient enforcement regimes but also to make social transfers and thus reduce the necessity for people to turn to employment in the informal economy as a survival practice. It is not only the level of employment in the informal economy however, that varies cross-nationally, but also its nature and its role in expanding the opportunities of the poor.

### **Country case studies: Brazil, China, India and South Africa**

In *Brazil* 92.9% of all business start-up unregistered and operating in the informal economy, 69.8% of formal firms with more than five employees compete against unregistered or informal firms and 49.1% identify the practices of competitors in the informal sector as a major constraint. Indeed, 42.3% of the non-agricultural workforce has their main employment in the informal economy, of which 57.2% are in informal jobs in informal enterprises. Examining whether employment in the informal economy is a ladder out of poverty or a cul-de-sac, a study investigates those moving out of poverty (i.e., upwards mobility). It finds that 3% of poor workers in the informal sector move out of poverty the following month but just 1% of poor formal sector workers. Thus, poor workers in the formal sector are less likely to escape poverty. Importantly, 85% of the informal workers moving out of poverty continue working in the informal sector and just 11% move from informal into formal jobs. Hence, workers are escaping poverty while remaining in the informal economy and the formal sector does not help people escape poverty as much as the informal sector. Reinforcing this, of the unemployed moving out of poverty, 37% did so by joining the informal economy and just 14% by taking formal jobs.

In *China*, meanwhile, 57.8% of formal firms with more than five employees compete against unregistered or informal firms but only 7.4% identify the practices of competitors in the informal sector as a major constraint. Indeed, 34.4% of non-agricultural workers have their main employment in the informal economy, of which 58.4% are in informal jobs in informal enterprises. In this country, employment in the informal economy directly results from the *hukou* system which assigns everyone a permanent place of registration and a status (agricultural or non-agricultural). This hukou system creates a large group of unregistered or 'illegal' migrants composed of *nongmingong* (peasant-workers) who are either employed in the cities and towns and have left the land and village (*litu lixiang*) or are locally employed and have left the land but not the village (*litu bu lixiang*). Some 168.2 million of the total urban labour force of 283 million (59%) operate in the informal economy, of which 120 million are *nongmingong* who work double the hours of formal urban workers for 60% of the pay of a regular urban labourer, just 12.5% have an employment contract, 10% medical insurance and 15% retirement benefits. A further 300 million informal workers are in agriculture. However, in China, almost all own the use rights of their 'responsibility land' which provides job security and differentiates them from their counterparts in other developing countries, like India.

*India* has one of the largest informal economies anywhere in the world; 99.3% of all businesses start-up unregistered and operating in the informal economy, and 84.3% of non-agricultural workers have their main employment in the informal economy, of which 79.2% are in informal jobs in informal enterprises. However, and perhaps reflecting how the few formal firms operate in a separate production realm, just 50.1% of formal firms with more than five employees compete against unregistered or informal firms and just 17.3% identify the practices of competitors in the informal sector as a major constraint. Many of these informal workers, moreover, do not see themselves as working informally out of necessity. Examining street vendors for example, just 12% explain their participation in street vending as necessity-driven, 15% as traditional ancestral activity, 56% as a rational economic choice and 17% as pursued for social or lifestyle reasons.

In *South Africa*, it is similarly the case that 85.5% of all business start-up unregistered and operating in the informal economy, 45.3% of formal firms with more than five employees compete against unregistered or informal firms, 11.3% identify the practices of competitors in the informal sector as a

major constraint, and 32.7% of the non-agricultural workforce has their main employment in the informal economy, of which 54.4% are in informal jobs in informal enterprises. Indeed, 39% of all employed women and 29% of all employed men have their main employment in the informal economy. Of all informal workers, 67% are informal employees, 25% own-account workers, 5% employers, and 3% unpaid family workers. Participation in the informal economy, however, is less common in metropolitan areas where 26% of employment is the informal economy, and they are concentrated in trade and private households (29% of all informal workers are in each sector), 12% in the construction sector, 8% in manufacturing and 7% in services other than private households. Unlike India, therefore, employment in the informal economy is less omnipresent and concentrated in particular sectors.

### **The informal economy: hindrance or help to expanding the opportunities of the poor?**

Conventionally, the argument has been that the informal economy is a hindrance to the expansion of opportunities of the poor because it has largely negative impacts. Economies are viewed as losing “natural” competitiveness because productive formal enterprises suffer unfair competition from unproductive informal enterprises, governments are viewed as losing regulatory control over work conditions and tax revenue, and customers as lacking legal recourse and certainty that health and safety regulations have been followed. Informal workers, meanwhile, are viewed as “necessity-driven”, lacking access to capital, credit and financial services, which when combined with their need to keep the business small to stay “under the radar” of the authorities, lack of advice and support and an inability to secure formal intellectual property rights to process and product innovations, mean that they become locked in a “poverty trap”.

Recently however, more positive depictions of its role in expanding the opportunities of the poor have emerged. Formal enterprises are viewed as potentially benefiting from cheaper sources of labour and raw materials, potential formal entrepreneurs from the opportunity to use this realm as a test-bed for their business ventures and informal entrepreneurs from this escape route from corrupt public officials and the regulatory burden in contexts where this stifles business development. Customers especially in “base of the pyramid” markets, meanwhile, are seen as potentially benefiting from more affordable goods and services.

Until now, however, there has been little empirical evaluation of these various views on how the informal economy acts as a hindrance or help in expanding the opportunities of the poor. An evidence-based evaluation of each of these purported positive and negative features thus provides a major agenda for future research on the informal economy.

To show the benefits of doing so, the view that informal enterprises are poorly performing unproductive endeavour and deleterious to economic development is evaluated. Evaluating the impacts of starting-up unregistered on firm performance across 127 countries, the finding is that once other determinants of firm performance are controlled for, formal enterprises that started-up unregistered have an annual average sales growth rate 19.4% higher (i.e., 8.6% compared with 7.2%) than firms starting-up registered, an annual average employment growth rate 34.7% (i.e., 6.6% compared with 4.9%) higher than enterprises starting-up registered and that starting-up unregistered has no significant deleterious impact on their annual productivity growth rate. This supports a more positive depiction of the informal sector as a seedbed and incubator for future higher-performing enterprises.

## **Policy options**

Hypothetically, with regard to the informal economy, policy could either: take no action; eradicate the informal economy; move formal work into the informal economy; or transform the informal work into formal work. Evaluating these four policy choices, the first option of taking no action is unacceptable. This would leave intact the current negative impacts on formal businesses (e.g., unfair competition), informal workers (e.g., the inability to gain access to credit to expand), customers (e.g., no guarantee of health and safety standards) and governments (e.g., taxes owed are not collected). Secondly, transforming formal into informal work is unacceptable because it levels down rather than up of working conditions and thirdly, eradicating the informal economy is unacceptable since it results in governments repressing and eradicating precisely the entrepreneurial endeavour and enterprise culture that they otherwise wish to foster. Transforming informal work into formal work thus appears to be the most viable policy choice. How, therefore, can this be achieved?

## **Policy approaches and measures**

One option is to ensure that the pay-off from informality is outweighed by the benefits of formality, either by increasing the penalties and risks of detection or improving the benefits of formalization. Indeed, the fact that enterprises starting-up unregistered outperform those starting-up registered reveals that the benefits of formalization currently remain insufficient for most businesses. However, increasing the costs of informality and/or the benefits of formalization both for workers and enterprises is not the only route to formalization. It assumes that informal workers are purely rational economic actors. In recent years, grounded in institutional theory, informal workers have been recognized as also social actors and informal work as arising when citizens' norms, values and beliefs are not in symmetry with the prescriptions of formal institutions. To facilitate formalization, therefore, the focus has been upon aligning citizens' norms, values and beliefs (citizen morality) with the rules of the formal institutions (state morality). On the one hand, this has sought measures to alter norms, values and beliefs regarding the acceptability of operating informally, such as by raising awareness about the benefits of taxation and the public goods and services received. On the other hand, it has sought to alter formal institutions in two ways. Firstly, improvements are sought in the processes of formal institutions such as tax fairness, procedural justice and redistributive justice. Secondly, improvements are also sought in those aspects of the wider institutional environment which lead to lower levels of informality, including tackling under-development, public sector corruption and poverty through increasing tax rates and social protection expenditure.

These approaches, however, are not mutually exclusive. Indeed, there are at least two ways of combining them. Firstly, a "responsive regulation" approach starts out by openly engaging citizens to self-regulate themselves in a manner consistent with the law. This facilitating of voluntary compliance is then followed by persuasion through incentives to formalize and only as a last resort uses punitive measures such as increased penalties. A second approach is the "slippery slope framework" which pursues both voluntary and enforced compliance concurrently by developing both greater trust in authorities and the greater power of authorities. Until now however, little evaluation exists of which sequencing and/or combination is the most appropriate and/or effective means of facilitating the formalisation of informal work.

This, therefore, is a major topic for future policy research on the informal economy. More widely, a comprehensive evaluation is required of the various purported negative and positive impacts of the informal economy. Until these are understood, it cannot be known whether the informal economy has a net positive or negative impact on expanding the opportunities of the poor. What is certain, however, is that eradicating the informal economy can no longer be assumed to be the way forward. Not only is a wider consideration required of the potential positive impacts of this sphere on

expanding opportunities of the poor but also more creative approaches regarding how informality may be harnessed to that end.

## INTRODUCTION

This report investigates the informal economy as a path to expanding opportunities and is part of a larger exploratory project on expanding opportunities for the poor. The intention is to analyse the ways in which various social, political and economic forces in developing societies limit the opportunities available to their residents, and, critically, do so in ways that may disproportionately affect the poor.

The original idea in the larger exploratory project of which this report is a part was to look more deeply at what “equality of opportunity” means and to build a stronger argument for this approach rather than redistribution. The more this was considered, the less appealing equality of opportunity became as a framework for policy making. Consequently, the notion of “expanding opportunities” was adopted as a potentially useful and practical way to develop policy programmes that will benefit the poor and those who historically have been disadvantaged in developing countries. The intention in the overarching project is to focus upon: the concept of expanding opportunities and explore its implications and value as a guide to policy makers; and practical ways in which opportunities can be expanded to those denied them in the past in (mainly) middle income developing countries, especially Brazil, China, India and South Africa.

To develop this approach, there is thus a need to consider more precisely the meaning of “opportunities”, and which are the best kind of opportunities to help get poorer people out of poverty.

During the exploratory first phase, the intention is to ask:

- Is “expanding opportunities” a useful lens to think about these issues in developing countries?
- In which ways could it influence policy priorities?
- How would we approach key policy priorities differently in developing countries through using this lens?
- How does it differ from equality of opportunity and other perspectives as an approach?

The core idea therefore is to look at how to deal with poverty and disadvantage from the perspective of the expanding opportunities lens, in developing countries in general, but more particularly in India, Brazil and South Africa as well as other developing countries (middle income ones mainly).

This report contributes to this wider body of innovative work by evaluating the informal sector as a path to expanding opportunities. In many developing countries, informal economic activities play a significant role in employment and even output. They are, therefore, important for reducing poverty. But are informal activities a route to greater prosperity (national and individual) and expanded opportunities? Are they ladders or cul de sacs? How and under what circumstances? This paper seeks answers to these questions by firstly, reviewing what is known about the extent and scale of informal activities in developing countries, especially in Brazil, India, China and South Africa, secondly, examining the evidence of whether, how and when this sector is able to expand opportunities and third and finally, if expanding opportunities is the goal, how countries should approach the informal sector and more precisely, what governments, private players and civil society organisations might do to both harness the informal sector more effectively for expanding opportunities and to assist at least some firms to transition into the formal sector. The outcome will be a review of the evidence from across the developing world in terms of how the informal sector both contributes to and undermines the expansion of economic opportunities for the poor and the disadvantaged, with a particular focus upon the poor in China, South Africa, Brazil and India.



To achieve this, section 2 reviews how the informal sector can be defined and its constituent components, section 3 reviews the prevalence of the informal sector across the developing world, section 4 country case studies of its prevalence and nature in Brazil, China, India and South Africa, and section 5 some of the evidence for viewing the informal economy as a help rather than hindrance to expanding the opportunities of the poor, including how this sphere represents a route to greater prosperity (national and individual). Section 6 then evaluates the hypothetical policy options in relation to this sphere. Finding that harnessing the informal sector is a route to expanding opportunities for the poor, the seventh and final section then reviews the various policy approaches and measures available for achieving this goal, along with the contrasting ways in which these various approaches and measures can be sequenced and/or combined.

## DEFINING THE INFORMAL ECONOMY

Employment in the informal economy is in this report defined using the widely accepted enterprise-based definition of the 'informal sector' and jobs-based definition of 'informal employment' developed by the 15th and 17th International Conference of Labour Statisticians (ICLS) respectively.<sup>3</sup> As Table 1 graphically displays, taking the enterprise as the unit of analysis, the 'informal sector' covers both formal and informal jobs in informal sector enterprises (A+B), whilst taking jobs as the unit of analysis, 'informal employment' covers informal jobs in both informal and formal enterprises (A+C). In this report, we combine both units of analysis and examine 'employment in the informal economy' (A+B+C) which covers all persons who in their main job are employed either in the informal sector (A+B) or in informal employment (A+C), counting only once those persons who are classified in both categories.

Table 1: The anatomy of informality

Economic units	Informal jobs	Formal jobs
Informal economic units	A	B
Formal economic units	C	D

Source: ILO (2012)

To delineate more precisely what is included in 'employment in the informal economy', therefore, firstly, informal enterprises (i.e., the enterprise-based concept of the 'informal sector') and secondly, informal jobs (i.e., the jobs-based concept of 'informal employment') must be defined. The 15th International Conference of Labour Statisticians in 1993 defined the 'informal sector' (i.e., informal enterprises) as private unincorporated enterprises that are unregistered or small in terms of the number of employed persons. An unincorporated enterprise is a production unit not constituted as a separate legal entity independently of the individual (or group of individuals) who owns it, and for which no complete set of accounts is kept. An enterprise is unregistered, meanwhile, when it is not registered under specific forms of national legislation (e.g., factories' or commercial acts, tax or social security laws, professional groups' regulatory acts). The issuing of a trade license or business permit under local regulations does not qualify as registration. An enterprise is small, meanwhile, when its size in terms of employment is below a specific threshold (e.g. five employees) determined according

<sup>3</sup> Hausmann, R. (2005). *Measuring the informal economy: From employment in the informal sector to informal employment*. Geneva: Working Paper No. 53, Policy Integration Department Bureau of Statistics International Labour Office; ILO (2012), *Statistical Update on Employment in the Informal Economy*, Geneva: International Labour Organisation.

to national circumstances.<sup>4</sup>

Given that this definition of the 'informal sector' (A+B) does not include those in informal jobs in formal enterprises (C), the 17th ICLS in 2003 adopted an alternative jobs-based definition of 'informal employment' (A+C) to capture such workers. This defines the employment relationship (i.e., a job) as 'informal employment' (A+C) when it lacks basic social or legal protections or employment benefits and may be found in the formal sector, informal sector or households. Persons in informal employment include the following types:

- a) own-account workers and employers employed in their own informal enterprises;
- b) members of informal producers' cooperatives (not established as legal entities);
- c) own-account workers producing goods exclusively for own final use by their household (if considered employed given that the production comprises an important contribution to the total household consumption and is included in the national definition of employment);
- d) contributing family workers in formal or informal enterprises; and
- e) employees holding informal jobs in formal enterprises, informal enterprises, or as paid domestic workers employed by households.

As regards (e), employees have informal jobs if their employment relationship is, in law or in practice, not subject to national labour legislation, income taxation, social protection or entitlement to certain employment benefits (e.g., advance notice of dismissal, severance pay, paid annual or sick leave). The reasons may be the following: non-declaration of the jobs or the employees; casual jobs or jobs of a limited short duration; jobs with hours of work or wages below a specified threshold; employment by unincorporated enterprises or by persons in households; jobs where the employee's place of work is outside the premises of the employer's enterprise; or jobs for which labour regulations are not applied, not enforced, or not complied with for any other reason.<sup>5</sup>

## **PREVALENCE OF THE INFORMAL ECONOMY**

### **Evaluating the degree and intensity of informalisation in developing societies**

There are only three known data-sets that provide evidence on the varying prevalence of the informal economy across countries and global regions. These are the World Bank Enterprise Surveys, the Global Entrepreneurship Monitor (GEM) and an International Labour Organisation dataset of 41 countries.

The World Bank Enterprise Survey (WBES) covers 135 countries and has collected data from 2002 to 2014, although a harmonized questionnaire and common methodology has only prevailed since 2006 and is currently restricted to 127 countries (including 41 in Africa, 13 in East Asia and the Pacific region, 29 in Europe and Central Asia, 31 in Latin America and Caribbean, 7 in the Middle East and North Africa, and 6 in South Asia. Of these, 25 are low-income countries, 42 lower middle income countries, 36 middle income countries, 4 upper middle income countries, and 20 high income countries). In each developing country, the WBES collects data using a stratified random sample of non-agricultural formal private sector businesses with five or more employees which is stratified by firm size, business sector and geographic region. The firm size strata in the WBES are 5-19 (small), 20-99 (medium), and 100+ employees (large-sized firms), while sector is broken down into manufacturing, services, transportation and construction. Public utilities, government services, health care, and financial

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<sup>4</sup> Hausmann, R. (2005). *Measuring the informal economy: From employment in the informal sector to informal employment*. Geneva: Working Paper No. 53, Policy Integration Department Bureau of Statistics International Labour Office.

<sup>5</sup> ILO (2012), *Statistical Update on Employment in the Informal Economy*, Geneva: International Labour Organisation.

services sectors are not included, and in larger economies, manufacturing sub-sectors are selected as additional strata on the basis of employment, value-added, and total number of establishments. Geographical regions within a country are selected based on which cities/regions collectively contain the majority of economic activity. The sampling frame is derived from the universe of eligible firms, normally obtained from the country's statistical office or another government agency such as the tax or business licensing authorities. Since 2006, all national surveys explain the source of the sample frame.

To analyse the prevalence of the informal economy, and as Table 2 reveals, the WBES uses four indicators of its prevalence. Analysing formal private sector firms with more than five employees, 54.5% globally view themselves as competing against unregistered enterprises or firms conducting some of their trade informally, and 28.2% identify the practices of competitors in the informal economy as a major constraint on their business. However, this varies across global regions, ranging from sub-Saharan Africa where 67.7% of firms compete against unregistered and informal competitors and 38.8% view this as a major constraint on their business, to High Income OECD nations where just 34.2% compete against unregistered or informal enterprises and only 14.5% view them as a major constraint on their business. Turning to whether formal businesses started-up unregistered, some 12% of formal private sector firms globally assert that they started operations operating on an unregistered basis and only later formalised their operations and on average they spent 0.7 years operating unregistered before formalising. Again, this varies globally ranging from 13.7% in Latin America and the Caribbean spending 1.2 years on average unregistered to just 2.8% in High Income OECD countries spending just 0.3 years unregistered.

Table 2: World Bank Enterprise Survey estimates of the prevalence of the informal economy (unweighted means)

Economy	Year of survey	% of firms competing against unregistered or informal firms	% of firms identifying practices of competitors in the informal sector as a major constraint	% of firms formally registered when they started operations	Number of years operated without formal registration
All countries	-	54.5	28.2	88.0	0.7
East Asia & Pacific	-	51.9	16.4	86.6	0.8
Eastern Europe & Central Asia	-	39.1	20.5	97.8	0.4
High Income non-OECD	-	56.0	25.2	91.7	0.6
High Income OECD	-	34.2	14.5	97.2	0.3
Latin America and Caribbean	-	62.3	31.3	86.3	1.2
Middle East & North Africa	-	42.6	31.4	86.6	0.6
South Asia	-	42.9	20.7	87.4	0.8
Sub-Saharan Africa	-	67.7	38.8	81.9	0.8
<i>Selected Countries:</i>					
Brazil	2009	69.8	49.1	94.9	0.2
China	2012	57.8	7.4	95.8	0.1
India	2014	50.1	17.3	87.2	0.7
South Africa	2007	45.3	11.3	91.0	0.3

Source: World Bank Enterprise Survey, author's calculations

Turning to the four countries which are the focus of this report, Table 2 reveals the cross-national variations in the prevalence of the informal economy. Examining formal private sector firms with more than five employees, the proportion viewing themselves as competing against unregistered

enterprises or firms conducting some of their trade informally ranges from 69.8% in Brazil to just 45.3% in South Africa, and the share of firms identifying the practices of competitors in the informal economy as a major constraint on their business ranges from 49.1% in Brazil to 7.4% in China. Turning to whether formal businesses started-up unregistered, this varies from 12.8% in India to 4.2% in China.

The importance of this WBES data, therefore, is that it reveals that the majority (54.5%) of enterprises globally compete against firms trading wholly or partially in the informal economy, and well over a quarter (28.2%) of all global enterprises identify the practices of competitors in the informal sector as a major constraint. This, therefore, provides some indication of the significance of the informal economy.

To identify the proportion of enterprises in the informal economy however, another dataset must be analysed. Autio and Fu draw on the Global Entrepreneurship Monitor (GEM) dataset which annually reports data on entrepreneurship in more than 70 countries and combine this with the World Bank Enterprise Snapshot, which tracks formal incorporations, to measure the relative prevalence rates of formal and informal start-ups.<sup>6</sup> The finding is that some 59% of all new businesses in OECD countries are informal, 62.6% in transition economies, but 83.8% in Asia Pacific countries, 91.2% in Latin American and the Caribbean countries and 98% in African countries. Therefore, the vast majority of business start-ups across the world are in the informal economy. This is also the case in the three countries selected for which data are available, with 92.9% of all business start-ups in Brazil being in the informal economy, 99.3% in India and 85.5% in South Africa. For governments to seek to eradicate enterprise starting-up in the informal economy would thus result in them seeking to stamp put with one hand precisely the entrepreneurship and enterprise culture that with another hand they are seeking to foster.

Table 3: Prevalence rates of informal and formal business start-ups: as number of new business entries per 100 adult-age population

	Formal entrepreneurship	Informal entrepreneurship	% of all business start-ups that are informal
Asia Pacific countries	0.39	2.03	83.8
Latin American & Caribbean countries	0.21	2.17	91.2
African countries	0.08	3.98	98.0
OECD countries	0.43	0.62	59.0
Transition countries	0.37	0.62	62.6
<i>Selected Countries:</i>			
Brazil	0.21	2.76	92.9
China	-	-	-
India	0.01	1.54	99.3
South Africa	0.11	0.65	85.5

Source: derived from Autio and Fu (2015: Table 1)

To measure the proportion of employment that is in the informal economy however, attention needs to turn to the International Labour Organisation dataset on 36 countries. Table 4 reports the level of employment in the informal economy (A+B+C in Table 1). This reveals that the simple unweighted average is that 57.4% of the non-agricultural workforce has their main employment in the informal economy. However, a weighted average figure is here used which takes into account the variable workforce size in each country. This reveals that across all 36 countries for which data is available,

<sup>6</sup> Autio, E. & Fu, K. (2015). Economic and political institutions and entry into formal and informal entrepreneurship. *Asia Pacific Journal of Management*, 32(1), 67-94.

three out of every five (59.8%) non-agricultural workers have their main employment in the informal economy. Employment in the informal economy, therefore, is not some minor residue of little importance but a large realm employing the majority of the workforce in these developing countries.

Table 4: Employment in the informal economy as % of non-agricultural employment (unweighted and weighted): by global region

Global region	Total employment in the informal economy as % of non-agricultural employment, unweighted	Total employment in the informal economy as % of non-agricultural employment, weighted	Number of countries
East Asia & Pacific	64.8	47.4	4
Europe and Central Asia	22.8	24.8	4
Latin America & Caribbean	58.2	51.1	16
Middle East & North Africa	59.0	58.5	1
South Asia	75.9	75.6	3
Sub-Saharan Africa	64.8	53.1	8
All global regions	57.4	59.8	36

Source: derived from ILO (2012)

However, these overall figures mask marked variations across global regions. The weighted proportion of the non-agricultural workforce whose main employment is in the informal economy ranges from just under one-quarter (24.8%) of the working population in Europe and Central Asia, through to 75.6% in South East Asia. The share of the working population whose main employment is in the informal economy, therefore, is not evenly distributed globally.

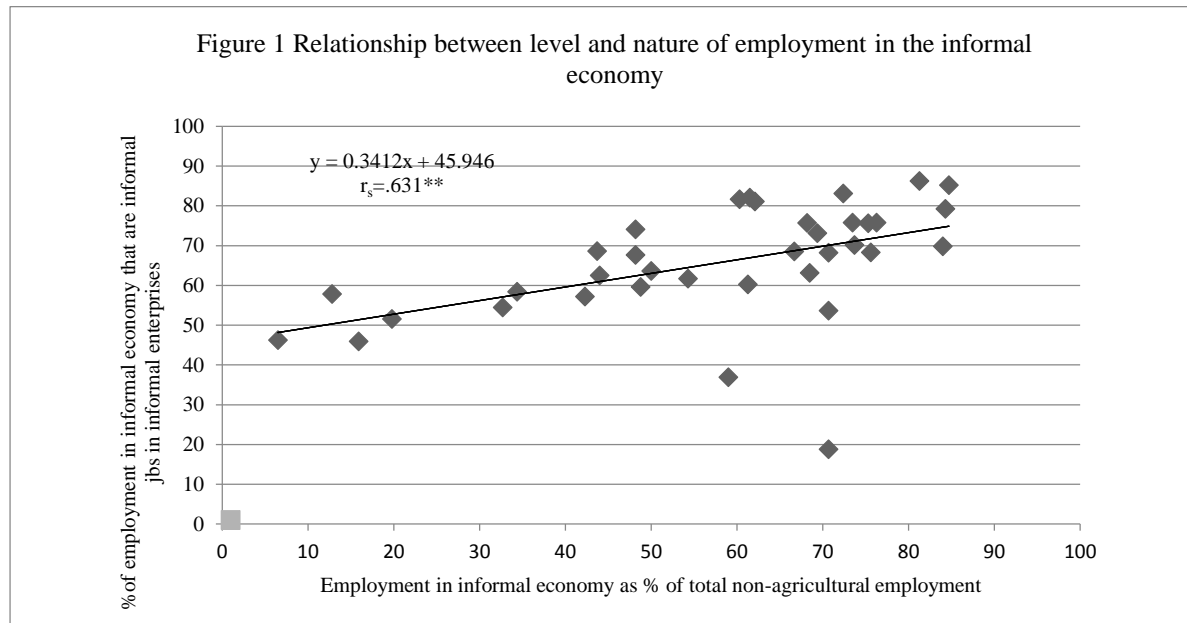
Table 5 examines the full data set on not only the cross-national variations in the level of employment in the informal economy (A+B+C in Table 1) but also the 'intensity of informalisation', namely the share of all employment in the informal economy which is informal employment in informal enterprises (A). This is here considered a measure of a more intense form of informalisation since both the job and the enterprise is informal, which is not the case with formal jobs in informal sector enterprises (B) and informal employment in formal enterprises (C). This reveals marked cross-national variations in employment in the informal economy, ranging from 84.7% of the non-agricultural workforce in Mali to 6.5% in Serbia. Indeed, in 24 (67%) of the 36 nations, over half of the non-agricultural workforce have their main employment in the informal economy. Of the four countries selected for deeper analysis, India has one of the highest levels of employment in the informal economy with 84.3% of the workforce having their main employment in the informal economy, whilst Brazil, China and South Africa are more at the bottom end with 42.3%, 34.4% and 32.7% of the workforce having their main employment in the informal economy.

Table 5: Extent and nature of employment in the informal economy as % of non-agricultural workforce

Country	Year	Employment in the informal economy as % of non-agricultural employment (A+B+C)	% of employment in the informal economy that is informal employment in informal enterprises
All	-	59.8	74.0
Mali	2004	84.7	85.2
<b>India</b>	<b>2009/10</b>	<b>84.3</b>	<b>79.2</b>
Philippines	2008	84.0	69.8
Pakistan	2009/10	81.3	86.2
Zambia	2008	76.3	75.8
Bolivia	2006	75.6	68.3
Honduras	2009	75.3	75.6
Madagascar	2005	73.7	70.1
Uganda	2010	73.5	75.8
Indonesia	2009	72.4	83.1
Lesotho	2008	70.7	18.8
Paraguay	2009	70.7	53.6
Peru	2009	70.7	68.2
Nicaragua	2009	69.4	73.1
Viet Nam	2009	68.5	63.1
El Salvador	2009	68.2	75.7
Tanzania	2005/6	66.7	68.5
Sri Lanka	2009	62.1	81.1
Colombia	2010	61.5	82.0
Ecuador	2009	61.3	60.2
Liberia	2010	60.3	81.6
West Bank & Gaza	2010	59.0	36.9
Mexico	2009	54.3	61.7
Argentina	2009	50.0	63.6
Dominican rep	2009	48.8	59.6
Venezuela	2009	48.2	74.1
Costa Rica	2009	48.2	67.6
Panama	2009	44.0	62.5
Uruguay	2009	43.7	68.6
<b>Brazil</b>	<b>2009</b>	<b>42.3</b>	<b>57.2</b>
<b>China</b>	<b>2010</b>	<b>34.4</b>	<b>58.4</b>
<b>South Africa</b>	<b>2010</b>	<b>32.7</b>	<b>54.4</b>
Armenia	2009	19.8	51.5
Moldova Rep	2009	15.9	45.9
Macedonia	2010	12.8	57.8
Serbia	2010	6.5	46.2

There is also a strong correlation between the degree of informalisation of employment (i.e., the proportion of the non-agricultural workforce in employment in the informal economy) and the intensity of informalisation (i.e., the share of all employment in the informal economy which is informal employment in informal enterprises). To see this, columns 3 and 4 of Table 5 report the degree and intensity of informalisation respectively. Examining the intensity of the informalisation of employment, the finding is that across all 36 developing countries, three-quarters (74%) of all employment in the informal economy is informal employment in informal enterprises. Again, however, there are marked cross-national variations, ranging from 85.2% in Mali to 18.8% in Lesotho. To analyse the correlation between the degree and intensity of the informalisation of employment, Figure 1 graphically displays that there is a statistically significant association. The greater is the degree of informalisation in a country, the higher is the intensity of the informalisation (i.e., the more likely is informal employment to be located in informal enterprises). Indeed, using Spearman's rank

correlation coefficient ( $r_s$ ) due to the non-parametric nature of the data, the finding is that this is a statistically significant within a 99% confidence interval ( $r_s = -.631^{**}$ ).



### Explaining cross-national variations in the prevalence of employment in the informal economy

Until now, there have been three competing explanations for the cross-national variations in the prevalence of employment in the informal economy. In the *modernisation thesis*, which dominated for most of the twentieth century, employment in the informal economy was widely depicted as a relic from a pre-modern production era which would fade away as the modern formal economy took hold. As Bromley asserts, from this perspective, employment in the informal economy is ‘unimportant and destined to disappear’. Such work is thus portrayed as a product of under-development which will disappear with economic advancement and modernisation. Cross-national variations in the degree and intensity of informalisation, therefore, are seen to signify the position of a country on a one-dimensional linear trajectory towards formalisation. Classifying countries using indicators such as GNP per capita, therefore, enable the relative level of economic advancement and modernisation to be measured and for countries to be placed according to their place in the development queue with nations at the fore being ‘advanced’, ‘modern’ and ‘progressive’ and nations at the back of the queue with low levels of formalisation being deemed ‘backward’, ‘traditional’ and ‘under-developed’.<sup>7</sup>

In recent decades, however, the recognition that the majority of jobs are in the informal economy in many countries and regions has seen the emergence of other explanations.<sup>8</sup>

<sup>7</sup>Geertz C. (1963). *Old Societies and New States: the quest for modernity in Asia and Africa*. Glencoe, IL: Free Press; Gilbert, A. (1998). *The Latin American City*. London: Latin American Bureau; Lewis, A. (1959). *The Theory of Economic Growth*. London, Allen and Unwin; Lewis, A. (1959). *The Theory of Economic Growth*. London, Allen and Unwin; Packard, T. (2007). *Do workers in Chile choose informal employment? a dynamic analysis of sector choice*. Washington DC: World Bank Latin American and the Caribbean Region Social Projection Unit.

<sup>8</sup> ILO (2012), *Statistical Update on Employment in the Informal Economy*, Geneva: International Labour Organisation; ILO (2013). *Women and men in the informal economy: statistical picture*, available at [http://laborsta.ilo.org/informal\\_economy\\_E.html](http://laborsta.ilo.org/informal_economy_E.html) (last accessed 10 January 2014); Schneider, F. & Williams, C.C. (2013). *The shadow economy*. London: Institute of Economic Affairs.

For an *agency-oriented* school of thought, the persistence and even growth of employment in the informal economy is deemed to be a populist reaction to high taxes, a corrupt state system and too much interference in the free market, leading workers to make a rational economic decision to voluntarily exit work in the formal economy in order to avoid the costs, time and effort of formal registration.<sup>9</sup> As Nwabuzor asserts, 'Informality is a response to burdensome controls, and an attempt to circumvent them'.<sup>10</sup> The consequent solution is to pursue tax reductions, reduce corruption, deregulation and minimal state intervention. From this perspective, therefore, employment in the informal economy should be more pervasive in countries with higher taxes and public sector corruption and greater state interference.

From a *structuralist* perspective, however, this persistence and expansion of employment in the informal economy is conceptualised as a direct by-product of the advent of a de-regulated open world economy. The increasing functional integration of a single global economic system results in subcontracting and outsourcing becoming a primary means of integrating employment in the informal economy into contemporary capitalism, causing a further downward pressure on wages and the erosion of incomes, social services and benefits, and the growth of yet more employment in the informal economy. Viewed through this conceptual lens, employment in the informal economy is a largely unregulated, low paid and insecure kind of survival-driven employment conducted under 'sweatshop-like' conditions by marginalised populations excluded from formal jobs and formal welfare support who turn to such work as a last resort.<sup>11</sup> Employment in the informal economy from this perspective will be therefore higher in economies where there is inadequate state intervention to protect workers from poverty.

Here, and using the data in Table 5, a preliminary analysis is undertaken of the validity of these three theoretical perspectives that variously explain employment in the informal economy by examining the association between the cross-national variations in the degree and intensity of informalisation and the cross-national variations in the various characteristics that each perspective deems to be important determinants. Beginning with the modernisation explanation that the share of employment in the informal economy is greater in less developed economies, the correlation between cross-national variations in the degree of informalisation and cross-national variations in GNP per capita is analysed across these 36 developing economies. Using Spearman's rank correlation coefficient, and as Figure 2 graphically displays, the finding is that there is a strong statistically significant relationship within a 99% confidence interval between the prevalence of employment in the informal economy in a country and its GNP per capita ( $r_s = -.520^{**}$ ). The direction of this relationship is that employment in the informal economy is higher in developing economies with lower levels of GNP per capita. There is

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Schneider, F. and D. Enste (2002), *The Shadow Economy: an international survey*, Cambridge: Cambridge University Press.

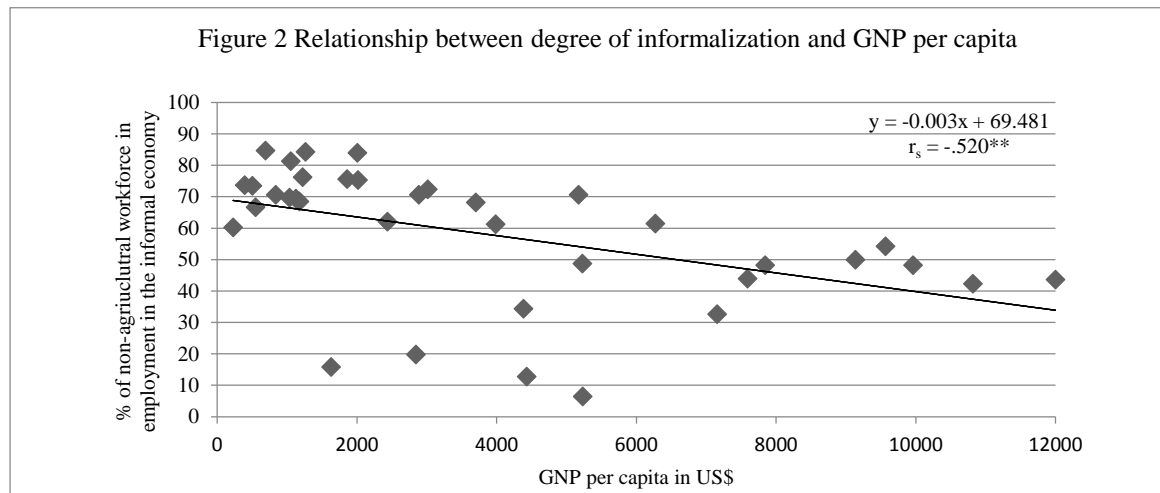
<sup>9</sup> Becker 2004; De Soto 1989 2001; London and Hart 2004; Nwabuzor 2005; Perry and Maloney 2007; Sauvy 1984; Small Business Council 2004

<sup>10</sup> Nwabuzor, A. (2005), 'Corruption and development: new initiatives in economic openness and strengthened rule of law', *Journal of Business Ethics*, 59(1/2), 121-38.

<sup>11</sup> Castells, M. & Portes, A. (1989). World underneath: the origins, dynamics and effects of the informal economy. In A. Portes, M. Castells & L. Benton (Eds.), *The Informal Economy: studies in advanced and less developing countries* (pp. 1-19). Baltimore: John Hopkins University Press; Gallin, D. (2001), 'Propositions on trade unions and informal employment in time of globalisation', *Antipode*, 19(4), 531-49; Sassen, S. (1997). *Informalisation in Advanced Market Economies*. Geneva: Issues in Development Discussion Paper 20, ILO; <sup>11</sup> Sassen, S. (1997). *Informalisation in Advanced Market Economies*. Geneva: Issues in Development Discussion Paper 20, ILO; Slavnic, Z. (2010), 'Political economy of informalization', *European Societies*, 12(1), 3-23; Taiwo, O. (2013), 'Employment choice and mobility in multi-sector labour markets: theoretical model and evidence from Ghana', *International Labour Review*, 152(3-4), 469-92.



also a statistically significant association within a 95% confidence interval between the intensity of informalisation and GNP per capita ( $r_s = -.351^*$ ). The intensity of informalisation (i.e., the share of all employment in the informal economy which is informal employment in informal enterprises) is greater in developing economies with lower levels of GNP per capita. However, and similar to previous studies that reach the same conclusion (ILO, 2012), it is not possible to here establish the direction of the correlation in terms of any cause-effect relationship. This, in consequence, is a limitation.



Turning to the agency-oriented perspective that views informalisation to be an outcome of higher tax rates, public sector corruption and interference by the state in the operation of the free market, the first step is to analyse the neo-liberal tenet that informalisation is greater when public sector corruption is higher because this results in citizens exiting the formal economy so as to seek livelihoods beyond the corrupt public sector officials. The finding is that there is a strong statistically significant association between countries with higher perceived levels of public sector corruption and a greater degree of informalisation ( $r_s = -.502^{**}$ ) and although the association between public sector corruption and the intensity of informalisation is not statistically significant ( $r_s = -.253$ ), the direction of the relationship is that countries with higher perceived levels of public sector corruption have a greater intensity of informalisation.

Analysing the core agency-oriented tenet that higher levels of employment in the informal economy are a product of exit from the formal economy due to high taxes, cross-national variations in the degree and intensity of informalisation are here compared with cross-national variations in tax rates. Beginning with the relationship between the cross-national variations in the degree of informalisation and the level of taxes on goods and services as a percentage of revenue, the finding is that there is a statistically significant correlation ( $r_s = -.430^*$ ). However, its direction is the inverse of what they suggest. The degree of informalisation decreases as taxes on goods and services increases. Meanwhile, although the relationship between the intensity of informalisation and the level of taxes on goods and services is not significant ( $r_s = -.216$ ), the direction is that the intensity of informalisation again decreases as taxes on goods and services increases.

Given that these findings begin to contest a core aspect of this agency-oriented theory, two further measures of tax levels are here evaluated. Analysing cross-national variations in the level of revenue (excluding grants) as a share of GDP and cross-national variations in employment in the informal economy, a statistically significant association is identified with both the degree of informalisation ( $r_s = -.510^{**}$ ) and intensity of informalisation ( $r_s = -.656^{**}$ ). Again, however, it is in the opposite direction to that suggested by this theory. It is similarly the case when the association between cross-national variations in the level of tax revenue as a proportion of GDP and cross-national variations in the degree

and intensity of informalisation are analysed. There is once more a strong statistically significant association with both the degree ( $r_s = -.451^*$ ) and intensity ( $r_s = -.679^{**}$ ) of informalisation but again, the association is the inverse of what the agency-oriented theory asserts. Across all three measures of tax rates therefore, the degree and intensity of informalisation is lower in nations with higher tax rates. One reason that higher tax levels might be correlated with lower degrees and intensities of informalisation may be that this provides greater state revenue to enable social transfers so that citizens can receive some level of social protection.

To evaluate this along with the agency-oriented argument that state interference in the operation of the market leads to a greater degree and intensity of informalisation, as well as the contrary structuralist view that the degree and intensity of informalisation reduces with greater state intervention, the relationship between cross-national variations in the degree and intensity of informalisation and the level of social contributions as a percentage of revenue can be analysed. The finding is that a strong significant correlation is identified between the level of social contributions and degree of informalisation ( $r_s = -.609^{**}$ ) and also the intensity of informalisation ( $r_s = -.582^*$ ). The direction of the relationship is that both the degree and intensity of informalisation reduces as social contributions rise as a share of revenue, intimating support for the structuralist explanation. No evidence is therefore found to support the agency-oriented argument that state intervention leads to informalisation. Instead, the structuralist tenet is validated that informalisation is correlated with too little state intervention in the form of social protection.

Finally, and turning to the structuralist tenet that cross-national variations in the degree and intensity of informalisation are associated with the level of poverty, again, a strong statistically significant relationship is found between cross-national variations in the proportion of the population living below the national poverty line and both the degree of informalisation ( $r_s = -.355^*$ ) but not the intensity of informalisation ( $r_s = .194$ ). The direction of this relationship is that the greater is the share of the population living below the national poverty line, the greater is the degree and intensity of informalisation, intimating that informalisation might well be a last resort turned to by marginalised groups with no other means of livelihood or support, as argued by the structuralist explanation.

In sum, evaluating these competing explanations which argue that the degree and intensity of informalisation is associated with economic under-development (modernisation thesis), higher taxes, corruption and state interference (agency-oriented thesis) and/or inadequate state intervention to protect workers from poverty (structuralist thesis), evidence has been found to support the modernisation and structuralist theses that associate greater informalisation with under-development and inadequate state protection of workers from poverty respectively and the agency-oriented corruption thesis that the degree of informalisation is higher in countries where the perception of public sector corruption is greater. However, no evidence has been found to support the validity of the agency-oriented theses that greater informalisation is associated with higher taxes and more state interference. Instead, quite the opposite has been found. Higher taxes and more state intervention reduce the degree and intensity of informalisation, presumably because of the ability of governments to not only have efficient enforcement regimes but also to make social transfers and thus reduce the necessity of the population to turn to employment in the informal sector as a survival practice.

These findings have significant implications for understanding what governments, private players and civil society organisations might do to both harness the informal sector more effectively for expanding opportunities as well as to assist at least some firms to transition into the formal sector. Currently, the policy debate surrounding employment in the informal economy is over whether targeted repressive

measures and/or targeted incentives are the most appropriate for facilitating formalisation.<sup>12</sup> The above, however, displays that wider economic and social policy measures are also important. Importantly, it reveals that the agency-oriented remedy of reducing taxes and de-regulating economies through minimising state intervention in work and welfare is not the way forward. No relationship is found either between lower tax rates and smaller informal economies, or between lower levels of state intervention and small informal economies. Instead, quite the opposite is found to be the case. The degree and intensity of informalisation is lower in modernised economies, with lower levels of public sector corruption, higher tax rates, greater levels of social protection expenditure and lower levels of poverty. Tackling employment in the informal economy, therefore, does not only require the development of targeted policy measures such as effective enforcement regimes but also appropriate wider economic and social policies, which means tackling under-development, public sector corruption and poverty through increasing tax rates and social protection expenditure. This will be returned to below. Before doing so nevertheless, the extent and nature of employment in the informal economy as well as its role in contributing to the alleviation of poverty for the poor is reviewed in each of the four countries selected for deeper analysis, namely Brazil, China, India and South Africa.

## CASE STUDIES

### Brazil

In Brazil 92.9% of all businesses start-up unregistered and operating in the informal economy (see Table 3). The WBES finds that 69.8% of formal firms with more than five employees compete against unregistered or informal firms and 49.1% identify the practices of competitors in the informal sector as a major constraint (see Table 2). Indeed, 42.3% of the non-agricultural workforce has their main employment in the informal economy, of which 57.2% are in informal jobs in informal enterprises (see Table 5).

In a review of employment in the informal economy in Brazil, Budlender defines self-employed workers as informal if they work in an enterprise with fewer than five employees and wage employees as informal if they do not have a *carteira de trabalho*, which registers their contract as one that is covered by fair labour relations in respect of working hours, minimum wages and other rights.<sup>13</sup> All unpaid family workers are classified as informal. Although analysts sometimes classify all domestic workers as informal, Budlender does not do so since more than a quarter (27%) of domestic workers have a *carteira de trabalho*.

Examining the non-agricultural labour force (which constitutes 83% of all Brazilian employment), 53% are formal workers and 47% informal workers. Of these informal workers, 46% are self-employed (employers or own-account workers), 50% are employees (including domestic workers) and 4% unpaid family workers. There are, however, gender variations; 48% of employed women are in the informal economy, compared with 45% of employed men, but 58% of women informal workers are employees (compared with just 42% of men). Men working in the informal economy, therefore, are more likely

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<sup>12</sup> Dibben, P. and Williams, C.C. (2012) "Varieties of capitalism and employment relations: informally dominated market economies", *Industrial Relations: a Review of Economy & Society*, 51(S1), 563-582; Williams, C.C. and Lansky, M. (2013) "Informal employment in developed and developing economies: perspectives and policy responses", *International Labour Review*, Vol. 152(3-4), 355 – 380; Williams, C.C. and Nadin, S. (2012a) "Entrepreneurship in the informal economy: commercial or social entrepreneurs?", *International Entrepreneurship and Management Journal*, 8(3), 309-324; Eurofound, 2013; Feld and Larsen, 2012; OECD, 2012; Williams et al., 2013

<sup>13</sup> Budlender, D (2011a) *Statistics on informal employment in Brazil*, WIEGO; Budlender, D (2011b) *Statistics on informal employment in South Africa*, WIEGO

to be self-employed. There are also differences in the type of jobs. Over a third (35%) of the women informal workers are domestic workers (but just 2% of men who are informal workers). In contrast, 23% of men are in construction, but less than 1% of women. Nevertheless, the proportions of women and men informal workers in trade are similar (23% and 20% respectively) as are the proportions in private non-domestic services (27% and 25%) and manufacturing (11% and 12%).

*Employment in the informal economy in Brazil: a ladder out of poverty or a cul-de-sac?*

To examine whether employment in the informal economy is a ladder out of poverty or a cul-de-sac, Machado and Perez-Ribas analyse whether those who are poor in a given month remain in poverty the following month by whether they work in the formal or informal economy and whether they transition to the formal or informal economy.<sup>14</sup> In Brazil's metropolitan areas, 70% of the poor in a given month remain in poverty the following month and 53% are still in poverty after 12 months, which is slightly lower than the 60% of low-income groups in the US and UK who remain in poverty after a year, suggesting that Brazilian metropolitan labour markets have been more effective in promoting income mobility for poor workers (defining poverty by per capita income in relation to the relative poverty line of 60% of median income).

Using Brazil's Monthly Employment Survey of 2004, Table 6 examines this income mobility by classifying workers aged 18-60 years old into three groups, namely formal workers, informal workers and the unemployed. Examining those moving out of poverty (i.e., upwards mobility), they find that 3% of poor workers in the informal sector move out of poverty the following month but just 1% of poor formal sector workers. Thus, poor workers in the formal sector are less likely to escape poverty. In other words, there is greater upwards mobility out of poverty for the poor working in the informal economy than for the poor working in the formal economy. Importantly, 85% of the informal workers who move out of poverty continue working in the informal sector and just 11% move from informal into formal jobs. Hence, these workers escape poverty while remaining in the informal economy. The formal sector therefore does not help people escape poverty as much as the informal sector. Reinforcing this, of those unemployed moving out of poverty, 37% did so by joining the informal economy and just 14% by taking formal jobs.

Table 6: Workers moving in and out of poverty in Brazilian metropolitan areas, 2004 (%)

Initial condition	Moving out of poverty	Condition the following month			
		Informal	Formal	Unemployed	Inactive
Informal	3	85	11	1	2
Formal	1	9	91	0	0
Unemployed	6	37	14	32	17

Initial condition	Falling into poverty	Condition the following month			
		Informal	Formal	Unemployed	Inactive
Informal	4	58	4	16	22
Formal	2	9	61	12	19
Unemployed	3	3	3	60	35

Source: Machado and Perez-Ribas (2008)

<sup>14</sup> Machado and Perez-Ribas, 2008

Nevertheless, there is greater vulnerability to downward mobility in the informal sector. Some 4% of informal workers who were not poor became poor after a month but just 2% of formal sector workers. Informal workers are perhaps more likely to fall into poverty because they may lack social protection. Overall however, there is greater upwards mobility out of poverty for the poor working in the informal economy than for the poor working in the formal economy, despite the greater vulnerability.

It is therefore perhaps unsurprising to find that those working in the informal economy are not all necessity-driven and do not always enter the informal economy as a last resort, but often voluntarily choose to enter the informal rather than the formal economy. As Williams and Youseff reveal in their analysis of an extensive 2003 survey conducted in urban Brazil of 37,016 informal sector entrepreneurs operating micro-enterprises with five or less employees, less than half (48.7%) of these entrepreneurs are driven out of necessity into entrepreneurial endeavour in the informal economy, although women are more commonly necessity-driven entrepreneurs and receive lower incomes from their entrepreneurial endeavour than men despite being better educated.<sup>15</sup> For many informal entrepreneurs, therefore, participation in this endeavour is a matter of choice, rather than due to a lack of choice. Some 16.5% state that their main reason was to seek independence, 8.4% that it was due to their experience or skills in the business, 8.1% that they were following a family tradition, 7.4% because it represented a promising business opportunity, 2.1% that it was a secondary job, 1.9% due to the flexibility in their working time that it afforded and 1% because of the opportunity presented by their partner. Of those informal entrepreneurs with employees, moreover, around one in five (18%) have a university degree, thus calling into question the depiction of informal entrepreneurs as largely composed of the illiterate and uneducated.

## China

The World Bank Enterprise Survey finds that 57.8% of formal firms with more than five employees in China compete against unregistered or informal firms but only 7.4% identify the practices of competitors in the informal sector as a major constraint (see Table 2). Indeed, 34.4% of non-agricultural workers have their main employment in the informal economy, of which 58.4% are in informal jobs in informal enterprises (see Table 5).

In China, the *hukou* system assigns everyone a permanent place of registration and a status (agricultural or non-agricultural). This determines their level of, and access to, social benefits and entitlements. Urban *hukous* are associated with urban citizenship and provide access to higher benefits and entitlements.<sup>16</sup> This *hukou* system creates a large group of unregistered or 'illegal' migrants composed of *nongmingong* (peasant-workers) who are either employed in the cities and towns and have left the land and village (*litu lixiang*) or are locally employed and have left the land but not the village (*litu bu lixiang*). The majority of these 200 million *nongmingong* do not enjoy official urban resident status and take the lowest paid work shunned by urban workers, both in the formal economy as temporary low-paid workers with benefits as well as outside the formal economy in small, so-called 'private enterprises' (*siying qiye*), or as self-employed *getihu*, or simply as unregistered labourers.

By 2006, 168.2 million of the total urban labour force of 283 million (59%) were estimated to operate outside the formal economy.<sup>17</sup> Most of the 168.2 million employees in the urban informal economy come from the 120 million *nongmingong* working in the cities. According to a 2006 official Chinese

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<sup>15</sup> Williams and Youseff, 2015

<sup>16</sup> Swider, S. (2014) Building China: precarious employment among migrant construction workers, *Work, Employment and Society* 29(1): 41-59; Swider, S. (2015) Reshaping China's urban citizenship: street vendors, Chengguan and struggles over the right to the city, *Critical Sociology*, 41(4-5): 701-16

<sup>17</sup> Huang, P.C.C. (2009) China's neglected informal economy: reality and theory, *Modern China*, 35(4): 405-38.

government report on this group cited by Huang these *nongmingong* are second-class citizens in the sense that they have no regular urban resident status and engage in low paid work for few or no benefits, working twice as long as regular urban labourers (11 hours per day) for on average just 60% of the pay of a regular urban labourer. Just 12.5% have a contract of employment, 10% medical insurance and 15% retirement benefits. Many work in small informal enterprises or are self-employed.<sup>18</sup>

There are also 48.2 million regular urban residents who work in the informal economy, many of whom lost their previous jobs in state-owned or collective enterprises. Most work in the informal service sector in transport and trade, eateries, social services, and so forth either in small so-called private enterprises, as self-employed individuals or in the kinds of job just one rung above those taken by the *nongmingong*.<sup>19</sup>

Of the 168.2 million urban informal workers, 69.6 million are officially registered with the State Administration for Industry and Commerce, of whom 39.5 million work in registered so-called private enterprises and 30.1 million as registered self-employed. The remaining 98.6 million are not registered with the State Administration for Industry and Commerce.

The so-called private enterprises are officially defined as enterprises owned by 'natural persons'. These 'natural persons owned' private enterprises account for 14% of all urban employed people and are almost all small businesses employing an average of 13 people. The 30.1 million urban self-employed *getihu*, meanwhile, and the 21.5 million 'rural'-registered *getihu*, work in 26 million entities with an average of 1.9 persons per enterprise, and include small shop and stall owners, repair shop owners and so forth. Finally, the 98.6 million unregistered urban informal employees work as domestics, home-based workers (e.g., seamstresses, laundresses), delivery boys/girls, apprentices, street vendors etc. Together, these three main groups that comprise the informal economy (private enterprises, the self-employed and the unregistered) are low paid, with little job security, few or no benefits and no protection under state labour laws. These 168.2 million urban informal employed, however, are a rung above the 80 million peasant workers who are locally employed in rural, non-agricultural informal units, including people working in the 'township and village' industries.

Outside of the above, there are 300 million in agriculture who similarly enjoy few benefits and legal protections. However, in China, almost all own the use rights of their 'responsibility land' which provides some job security, meaning that they are different to their counterparts in other developing countries, like India.

## India

India has one of the largest informal economies anywhere in the world. Indeed, the formal economy is only a minor segment of the economy. Reflecting this, 99.3% of all business start-up unregistered and operating in the informal economy (see Table 3). Moreover, 84.3% of non-agricultural workers have their main employment in the informal economy, of which 79.2% are in informal jobs in informal enterprises (see Table 5). However, and perhaps reflecting how the few formal firms operate in a separate production realm, the World Bank Enterprise Survey finds that just 50.1% of formal firms with more than five employees compete against unregistered or informal firms and just 17.3% identify the practices of competitors in the informal sector as a major constraint (see Table 2).

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<sup>18</sup> Huang, P.C.C. (2009) China's neglected informal economy: reality and theory, *Modern China*, 35(4): 405-38.

<sup>19</sup>ibid

Who, therefore, are these informal entrepreneurs, many of whom display a preference for working in the informal sector? What type of work do they conduct? And why do they work in the informal sector? What do they view as the advantages and disadvantages of working in this sphere? To answer these questions, a study by Williams and Gurtoo during 2006 and 2007 is reported on the working lives and work places of informal sector workers in five Indian states consisting of 1,700 interviews with eight occupations, namely carpenters, mechanics, cobblers, rickshaw drivers (hand driven and motorised), house helps or maids, vegetable and fruit vendors or hawkers, helpers in small shops or commercial establishments, and office helps or peons.<sup>20</sup> Starting with the issue of the type of work conducted by these informal entrepreneurs, some 75% work in selling jobs (e.g., vending of fruits, vegetables, tea etc.), and 50% were educated to high school or graduate degree level. They were relative young, with an average age of 33 years. Investigating what encouraged these self-employed to work in the informal sector, and what advantages they identified from working in the informal sector, reveals that some 62% asserted that it enabled them to establish their fledgling enterprise at minimal cost, whilst a further 22% asserted that it gave them flexibility over their work schedules and another 21% that they did so due to community support among the people living in the area and the same industry/profession for them establishing their enterprise on an informal basis. The disadvantages of working in the informal sector, meanwhile, were asserted to be the irregular income/wages (cited by 30%) and the lack of social protection/benefits (29%)

Contrary to the conventional structuralist depiction that informal workers are largely waged workers, this study also reveals that this is not the case; some 49% are own-account workers, 30% are daily wage workers and just 21% waged employees. They also find of those engaged in informal entrepreneurship, 66% were opportunity-driven and only 27% had resorted to start-up activity out of necessity. Many informal self-employed or own-account operators in India, in consequence, appear to be opportunity driven and operating informally, not out of necessity, but due to the ease and comfort of operating in this system. Similar findings are identified in a study of street vendors.<sup>21</sup> report face-to-face interviews with 871 street entrepreneurs in the Indian city of Bangalore conducted during 2010 concerning their reasons for participation in street entrepreneurship. The finding is that 12% explain their participation in street entrepreneurship as necessity-driven, 15% as traditional ancestral activity, 56% as a rational economic choice and 17% as pursued for social or lifestyle reasons. The outcome is a call to combine the previously rival explanations in order to develop a richer and more nuanced theorisation of the multifarious motives for street entrepreneurship in emerging market economies.

## South Africa

In South Africa 85.5% of all business start-up unregistered and operating in the informal economy (see Table 3). The World Bank Enterprise Survey finds that 45.3% of formal firms with more than five employees compete against unregistered or informal firms and 11.3% identify the practices of competitors in the informal sector as a major constraint (see Table 2). Indeed, 32.7% of the non-agricultural workforce has their main employment in the informal economy, of which 54.4% are in informal jobs in informal enterprises (see Table 5).

Examining the Quarterly Labour Force Survey (QLFS) conducted in the second quarter of 2010 by Statistics South Africa, Budlender estimates that of the total population of South Africa of 49.3 million people, 33.8 million (69%) are working age, of whom two-thirds (65%) live in urban areas and 38% in

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<sup>20</sup> Williams and Gurtoo (2009)

<sup>21</sup> Williams, C.C. and Gurtoo, A. (2012) "Evaluating competing theories of street entrepreneurship: some lessons from Bangalore, India", *International Entrepreneurship and Management Journal*, 8(4), 391-409.

the six metropolitan areas.<sup>22</sup> Just 45% of working age men and 32% of working age women are employed, 19% of men and 18% of women are unemployed, and the remaining 36% of men and 50% of women are not economically active (e.g., homemakers, people too old to work, and those studying full-time).

Statistics South Africa's definition of informal employment includes all workers in the informal sector. Employers, own-account workers and unpaid family workers are defined as in the informal sector if the enterprise is not registered for value added tax (VAT) or income tax. Employees are defined as informal if their employer does not deduct income tax from their pay and if the business in which they work has fewer than five employees. Informal employment also includes employees in the formal sector and private households whose employers do not contribute to their pension or medical insurance, and who also do not have a written contract of employment. Statistics South Africa, nevertheless, treats all domestic workers as informal, even though some employers contribute to their pension or medical insurance or they have written contracts of employment.

Some 33% of all employed people are informal workers; 39% of all employed women and 29% of all employed men. Breaking down these informal workers, 67% are informal employees, 25% are own-account workers, 5% employers, and 3% unpaid family workers.

Participation in the informal economy, however, is less common in metropolitan areas where 26% of employed people are informal workers (29% of employed women and 23% of employed men). Of these, 66% are informal employees, 24% own-account workers, 6% employers, and 3% unpaid family workers. Examining the types of work conducted in the informal economy, the largest realms of informal work in metropolitan areas are trade and private households (29% of all informal workers in each sector). The percentage of informal workers in trade is similar for women (27%) and men (31%). However, only 10% of men informal workers in the metropolitan areas are in private households compared with 50% of women informal workers. In the third biggest sector, construction, employing 12% of all informal workers, 21% of male informal workers but only 2% of women informal workers, are found. Manufacturing (8%) and services other than private households (7%) are the fourth and fifth biggest sectors of metropolitan informal employment.

If we compare metropolitan areas in different provinces, there are only small differences in the sectoral profile of informal workers. Cape Town has a higher proportion of informal workers in construction (17%), manufacturing (11%) and non-household services (10%) than the other metropolitan areas, and the lowest proportion (25%) in trade. EThekweni has the highest proportion in agriculture (3%), and Nelson Mandela has the highest proportion in transport (11%).

Examining domestic workers, occupation code 9131 can be used, which is a narrow definition of domestic workers that includes only those classified as unskilled general domestic workers. It excludes, for example, about 72,000 housekeepers and childcare workers employed by private households, most of whom are informal workers. Even with the narrow definition, the QLFS records more than 900,000 domestic workers. Statistics South Africa's dataset categorizes all these workers as informal workers. Analysis of the dataset shows that 22% of these domestic workers should be classified as formal workers if the definitional rules are followed because their employer contributes to medical insurance or pension or they have a written contract. Almost all (96%) the domestic workers are women. Domestic workers account for 20% of all informal workers in non-metropolitan areas and 23% of all informal workers in the metros. Domestic workers account for nearly a third (31%) of all informal workers in Nelson Mandela. In contrast, in Cape Town they account for 18% of all informal workers.

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<sup>22</sup>Budlender, D (2011b) Statistics on informal employment in South Africa, WIEGO



We classify informal workers as street traders if they give their occupation as street vendors of food or non-food products (occupation codes 9111 and 9112 respectively). More than 530,000 street traders are recorded in the QLFS, of whom 70% are women. Only a third (33%) of these workers are in metro areas. Almost all (97%) the street traders are informal workers. As Willemse highlights, this plays an important role in providing a security net for those excluded from the formal labour market.<sup>23</sup> However, as Valodia and Devey caution, poverty should not be seen as purely located in the informal economy and as structurally disconnected from the formal economy in South Africa.<sup>24</sup> Indeed, Sparks and Barnett argue that there is a need to move beyond depicting the informal economy as a marginalized survival sector which mops up excess workers and towards viewing it more positively as a vibrant entrepreneurial part of the economy which can stimulate economic growth and job creation.<sup>25</sup>

## THE INFORMAL ECONOMY: HINDRANCE OR HELP TO EXPANDING THE OPPORTUNITIES OF THE POOR

### Reviewing the negative and positive impacts of the informal economy

Is the informal economy a help or a hindrance to expanding the opportunities of the poor? Conventionally, the argument has been that the informal economy is a hindrance to the expansion of opportunities of the poor because it has largely negative impacts. In recent years however, it has been recognised that the informal economy may well be a help due to a range of previously unrecognised positive impacts resulting from engagement in this realm. In this section, these various negative and positive impacts of the informal economy are reviewed.

For much of the twentieth century, the informal economy in developing countries was largely deemed unworthy of scholarly attention. A modernization theory prevailed that depicted informal endeavour as some minor and declining remnant of an earlier mode of production and its continuing persistence in countries as signalling their “underdevelopment” and “backwardness.”<sup>26</sup> The widespread belief was that the informal economy would naturally and inevitably disappear with economic advancement and modernization. Over the last few decades however, the informal economy has been recognized as an extensive and persistent feature of the developing world. The informal sector been estimated as equivalent to 40-60% of GDP in developing economies, with 60% of the global workforce having their main employment in the informal sector.<sup>27</sup>, of which 70% are self-employed, and at least two-thirds of businesses in developing countries have been shown to be unregistered at start-up.<sup>28</sup>; <sup>29</sup> This recognition of the extensiveness of the informal economy has resulted in the emergence of new representations.

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<sup>23</sup> Willemse, L. (2011) Opportunities and constraints facing informal street traders: evidence from four South African cities, *Town and Regional Planning* 59: 7-15.

<sup>24</sup> Valodia, I. and Devey, R. (2012) The informal economy in South Africa: debates, issues and policies, *Margin: The Journal of Applied Economic Research*, 6(2): 133-57.

<sup>25</sup> Sparks, D.I. and Barnett S.T. (2010) The informal sector in sub-Saharan Africa: out of the shadows to foster sustainable employment and equity? *International Business and Economics Research Journal*, 9(5): 1-12.

<sup>26</sup> Geertz C. (1963). *Old Societies and New States: the quest for modernity in Asia and Africa*. Glencoe, IL: Free Press; Gilbert, A. (1998). *The Latin American City*. London: Latin American Bureau; Lewis, A. (1959). *The Theory of Economic Growth*. London, Allen and Unwin.

<sup>27</sup> Jütting, J. & Laiglesia, J. (2009). Employment, poverty reduction and development: what’s new? In J. Jütting and J. Laiglesia (Eds.), *Is Informal Normal? Towards more and better jobs in developing countries* (pp. 129-52). Paris: OECD.

<sup>28</sup> ILO (2013). *Women and men in the informal economy: statistical picture*, available at [http://laborsta.ilo.org/informal\\_economy\\_E.html](http://laborsta.ilo.org/informal_economy_E.html) (last accessed 10 January 2014)

<sup>29</sup> Autio, E. & Fu, K. (2015). Economic and political institutions and entry into formal and informal entrepreneurship. *Asia Pacific Journal of Management*, 32(1), 67-94.

Firstly, some have updated conventional modernization theory.<sup>30</sup> Although recognizing the persistence and magnitude of informality, this nonetheless maintains the depiction of two disconnected sectors and a negative representation, portraying informal workers and enterprises as typically composed of uneducated people operating small unproductive enterprises in separate “bottom of the pyramid” markets producing low-quality products for low-income consumers using little capital and adding little value.<sup>31</sup>

A second grouping of structuralist scholars however, recognizes that the formal and informal economies are not disconnected. Instead, the growth of informality is deemed an inherent feature and direct by-product of a deregulated open world economy where outsourcing and subcontracting have become ways of integrating informal enterprises into contemporary capitalism so as to reduce production costs.<sup>32</sup> Moreover, the weak state involvement in social protection and economic intervention resulting from de-regulation is viewed as pushing those excluded from the formal labor market and social protection into informality as a survival strategy.<sup>33</sup> Nevertheless, although recognizing informality as inter-twined with the formal realm, it remains seen as having negative impacts.

As summarized in Table 7, the modernization and structuralist perspectives depict the informal economy as a hindrance to expanding the opportunities of the poor. Economies are viewed as losing “natural” competitiveness because productive formal enterprises suffer unfair competition from unproductive informal enterprises.<sup>34</sup> Governments are viewed as losing both regulatory control over work conditions and tax revenue, and customers as lacking legal recourse and certainty that health and safety regulations have been followed.<sup>35</sup> Informal workers, meanwhile, are viewed as “necessity-driven”, lacking access to capital, credit and financial services, which when combined with their need to keep the business small to stay “under the radar” of the authorities lack of advice and support and

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<sup>30</sup> La Porta, R. & Shleifer, A. (2008). The Unofficial Economy and Economic Development. *Brookings Papers on Economic Activity*, 47(1), 123-135.

<sup>31</sup> La Porta, R. & Shleifer, A. (2014). Informality and Development. *Journal of Economic Perspectives*, 28(3), 109-126.

<sup>32</sup> Castells, M. & Portes, A. (1989). World underneath: the origins, dynamics and effects of the informal economy. In A. Portes, M. Castells & L. Benton (Eds.), *The Informal Economy: studies in advanced and less developing countries* (pp. 1-19). Baltimore: John Hopkins University Press; Davis, M. (2006), *Planet of Slums*, London, Verso; Meagher, K. (2010). *Identity Economics: social networks and the informal economy in Nigeria*. New York: James Currey; Slavnic, Z. (2010), ‘Political economy of informalization’, *European Societies*, 12(1), 3-23; Taiwo, O. (2013), ‘Employment choice and mobility in multi-sector labour markets: theoretical model and evidence from Ghana’, *International Labour Review*, 152(3-4), 469-92.

<sup>33</sup> Chen, M. (2012). *The Informal Economy: definitions, theories and policies*. Manchester: Women in Informal Employment Global and Organising.

<sup>34</sup> Leal Ordóñez, J.C. (2014). Tax collection, the informal sector and productivity. *Review of Economic Dynamics*, 17, 262-286.

<sup>35</sup> ILO (2014), *Transitioning from the informal to the formal economy*. Report V (1), International Labour Conference, 103rd Session (2014), Geneva: ILO; Bajada, C. & Schneider, F. (2005). Introduction. In C. Bajada & F. Schneider (Eds.), *Size, Causes and Consequences of the Underground Economy: an international perspective* (pp. 1-14). Aldershot: Ashgate.; Williams, C.C. (2014b) “Tackling enterprises operating in the informal sector in developing and transition economies: a critical evaluation of the neo-liberal policy approach”, *Journal of Global Entrepreneurship Research*, 2(9), doi: 10.1186/2251-7316-2-9, <http://www.journal-jger.com/content/2/1/9>.; Williams, C.C. (2014b) “Tackling enterprises operating in the informal sector in developing and transition economies: a critical evaluation of the neo-liberal policy approach”, *Journal of Global Entrepreneurship Research*, 2(9), doi: 10.1186/2251-7316-2-9, <http://www.journal-jger.com/content/2/1/9>.; Barbour, A. & Llanes, M. (2013). *Supporting People to Legitimise their Informal Businesses*. York: Joseph Rowntree Foundation.

an inability to secure formal intellectual property rights to process and product innovations (De Beer *et al.*, 2013), mean that they become locked in a “poverty trap”.<sup>36</sup>

Table 7: Informal economy: help or hindrance to expanding the opportunities of the poor?

Informal economy as a hindrance	Informal economy as a help
<i>For formal businesses:</i>	
Causes unfair competition for legitimate businesses	Acts as a test-bed for business start-ups.
Encourages ‘race to the bottom’ as legitimate businesses evade regulatory compliance to compete with these shadow businesses	Enables outsourcing and sub-contracting to reduce production costs
<i>For informal businesses:</i>	
Growth hindered because unable to access capital and secure the business support available to legitimate businesses	Can test-trade the viability of their business venture.
Pressured into exploitative relationships with legitimate businesses	Provides exit strategy in contexts where the regulatory burden stifles business development
Difficulty in expanding a business which cannot be openly advertised.	Provides entrepreneurs with escape route from corrupt public sector officials
<i>For informal workers:</i>	
Lack of access to credit and financial services, partly due to limited credit history.	A source of income to stay out of poverty.
No entitlement to labour rights such as minimum wage, sick pay, working hours directives or redundancy rights.	Flexibility in where, when and how to work (especially important for women who remain responsible for child-care).
May face higher barriers of entry to the formal market on account of an inability to provide employment history to back up their skills.	Reduces barriers to entry into work because the majority of shadow work starts with close social relations.
Cannot build-up rights to the state pension and other contributory benefits, and access occupational pension schemes	
Lack access to health and safety standards in the workplace, as well as bargaining rights and voice	
<i>For customers:</i>	
Lack legal recourse if a poor job is done, insurance cover; guarantees in relation to the work conducted, and certainty that health and safety regulations have been followed.	A more affordable product or service can be offered to or asked for by customers if payment is made in cash and no receipts change hands

<sup>36</sup> Castells, M. & Portes, A. (1989). World underneath: the origins, dynamics and effects of the informal economy. In A. Portes, M. Castells & L. Benton (Eds.), *The Informal Economy: studies in advanced and less developing countries* (pp. 1-19). Baltimore: John Hopkins University Press; ILO (2014), *Transitioning from the informal to the formal economy*. Report V (1), International Labour Conference, 103rd Session (2014), Geneva: ILO; Williams, C.C. Adom, K., Nadin, S. and Youssef, Y. (2012) “Gender variations in the reasons for engaging in informal sector entrepreneurship: some lessons from urban Brazil”, *International Journal of Entrepreneurship and Small Business*, 17(4), 478-494; De Beer, J., K. Fu and S. Wunsch-Vincent (2013), *The Informal Economy, Innovation and Intellectual Property: concepts, metrics and policy considerations*, Geneva: Economic Research Working Paper no. 10, World Intellectual Property Organization; McKenzie, D. & Woodruff, C. (2006). Do entry costs provide an empirical basis for poverty traps? Evidence from microenterprises. *Economic Development and Cultural Change* 55(1), 3-42

*For societies:*

Causes a loss of revenue for the state in terms of non-payment of income tax, national insurance and VAT	Stops governments pursuing burdensome regulatory regimes
Has knock-on effects on attempts to create social cohesion at a societal level by reducing the money available to governments to pursue social integration and mobility	'On the job' training in shadow businesses reduces pressure on state and its agencies during times of reduced public spending.
Leads to a loss of regulatory control over the quality of jobs and services provided in the economy	Breeding ground for the micro-enterprise system
If a significant segment of the population is routinely engaged in such activity, it may well encourage a more casual attitude towards the law more widely	Income from shadow entrepreneurship spent in the formal economy boosts demand for formal goods and services and contributes to 'official' economic growth.

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Recently however, more positive depictions of this sphere as helpful to expanding the opportunities of the poor have emerged. Formal enterprises are viewed as potentially benefiting from cheaper sources of labor and raw materials potential formal entrepreneurs from the opportunity to use this realm as a test-bed for their business ventures and informal entrepreneurs from this escape route from corrupt public officials and the regulatory burden in contexts where this stifles business development.<sup>37</sup> Customers especially in “base of the pyramid” markets, meanwhile, are seen as potentially benefiting from more affordable goods and services.<sup>38</sup>

A catalyst for this more positive, or what La Porta and Schleifer call “romantic”, representation, has been recognition that participation in the informal economy is not always necessity-driven but often a matter of choice.<sup>39</sup> The resultant agency-oriented theorizations of the informal economy are of two broad varieties. On the one hand, a group of mostly neo-liberal scholars depict informal workers and enterprises as rational economic actors who, after weighing up the costs of informality and benefits of formality, decide not to operate in the formal economy. Indeed, the prevalence of the informal

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<sup>37</sup> Ketchen, D.J., Ireland, R.D. & Webb, J.W. (2014). Towards a research agenda for the informal economy: a survey of the Strategic Entrepreneurship Journal's Editorial Board. *Strategic Entrepreneurship Journal*, 8, 95-100; Williams, C.C. & Martinez-Perez, A. (2014a). Is the informal economy an incubator for new enterprise creation? a gender perspective. *International Journal of Entrepreneurial Behaviour and Research*, 20(1), 4-19; Puffer, S.M., McCarthy, D.J. & Boisot, M. (2010). Entrepreneurship in Russia and China: The Impact of Formal Institutional Voids. *Entrepreneurship Theory and Practice*, Richardson, M. & Sawyer, A. (2001). A taxonomy of the tax compliance literature: further findings, problems and prospects. *Australian Tax Forum*, 16(2), 137-320; Tonoyan, V., Strohmeyer, R., Habib, M. & Perlitz, M. (2010). Corruption and entrepreneurship: how formal and informal institutions shape small firm behaviour in transition and mature market economies. *Entrepreneurship Theory and Practice*, 34(5), 803-31.

<sup>38</sup> Ketchen, D.J., Ireland, R.D. & Webb, J.W. (2014). Towards a research agenda for the informal economy: a survey of the Strategic Entrepreneurship Journal's Editorial Board. *Strategic Entrepreneurship Journal*, 8, 95-100; London, T., Esper, H., Grogan-Kaylor, A. & Kistruck, G.M. (2014). Connecting poverty to purchase in informal markets. *Strategic Entrepreneurship Journal*, 8, 37-55

<sup>39</sup> La Porta, R. & Schleifer, A. (2014). Informality and Development. *Journal of Economic Perspectives*, 28(3), 109-126; Cross, J.C. (2000). Street vendors, modernity and postmodernity: conflict and compromise in the global economy. *International Journal of Sociology and Social Policy*, 20(1), 29-51; Franck, A.K. (2012). Factors motivating women's informal micro-entrepreneurship: experiences from Penang, Malaysia. *International Journal of Gender and Entrepreneurship*, 4(1), 65-78; Gërkhani, K. (2004). The informal sector in developed and less developed countries: a literature survey. *Public Choice*, 120(3/4), 267-300; Maloney, W.F. (2004). Informality revisited. *World Development*, 32(7), 1159-78; Perry, G.E. & Maloney, W.F. (2007). Overview - informality: exit and exclusion, In G.E. Perry, W.F. Maloney, O.S. Arias, P. Fajnzylber, A.D. Mason & J. Saavedra-Chanduvi (Eds.), *Informality: exit and exclusion* (pp.1-20). Washington DC: World Bank.

economy in developing compared with developed countries is viewed to result from the higher costs (e.g., time and effort to formally register, burdensome regulations, compliance costs) and lower benefits of formalization, which commonly mean that the overall costs of formalizing do not exceed the benefits.<sup>40</sup>

On the other hand, and drawing inspiration from institutional theory (another agency-oriented group of scholars adopting a more “social actor” approach, view the informal economy as existing outside of formal institutional prescriptions but within the norms, values and beliefs of informal institutions and therefore as socially legitimate activity. Street vendors, modernity and postmodernity: conflict and compromise in the global economy. The informal economy thus results from formal institutional voids, such as relatively weak legal and contract enforcement systems, the absence of social protection and basic infrastructure including water, electricity and the internet and/or “because of the incongruence between what is defined as legitimate by formal and informal institutions”.<sup>41</sup> If symmetry exists between formal and informal institutions, participation in the informal economy would only occur unintentionally (e.g., due to a lack of awareness of the codified laws and regulations). When formal and informal institutions do not align however, the result is greater participation in the informal economy. Indeed, the greater the degree of asymmetry, the greater the participation in the informal economy.<sup>42</sup>

Until now, however, there have been few empirical evaluations of the above purported ways in which the informal economy is asserted to act as a hindrance or help in expanding the opportunities of the poor. An evidence-based evaluation of these supposed positive and negative features thus provides a major agenda for future research on the informal economy. Here, and to show the benefits of pursuing such research, the negative depiction of informal enterprises are poorly performing unproductive endeavour is put under the spotlight. Until now, as will now be shown, few have so far questioned this premise and the resultant view that the informal economy is deleterious to economic development and growth.

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<sup>40</sup> De Soto, H. (1989), *The Other Path: the economic answer to terrorism*, London: Harper and Row; De Soto, H. (2001). *The Mystery of Capital: why capitalism triumphs in the West and fails everywhere else*. London: Black Swan; Nwabuzor, A. (2005), ‘Corruption and development: new initiatives in economic openness and strengthened rule of law’, *Journal of Business Ethics*, 59(1/2), 121-38; Cross, J.C. (2000). Street vendors, modernity and postmodernity: conflict and compromise in the global economy. *International Journal of Sociology and Social Policy*, 20(1), 29-51.

<sup>41</sup> Puffer, S.M., McCarthy, D.J. & Boisot, M. (2010). Entrepreneurship in Russia and China: The Impact of Formal Institutional Voids. *Entrepreneurship Theory and Practice*, Richardson, M. & Sawyer, A. (2001). A taxonomy of the tax compliance literature: further findings, problems and prospects. *Australian Tax Forum*, 16(2), 137–320; Sutter, C.J., Webb, J.W., Kistruck, G.M. & Bailey, A.V.G. (2013). Entrepreneurs’ responses to semi-formal illegitimate institutional arrangements. *Journal of Business Venturing*, 28(5), 743-58; Webb, J.W., Tihanyi, L., Ireland, R.D. & Sirmon, D.G. (2009). You say illegal, I say legitimate: entrepreneurship in the informal economy. *Academy of Management Review*, 34(3), 492-510.

<sup>42</sup> De Castro J.O., Khavul, S. & Bruton, G.D. (2014). Shades of grey: how do informal firms navigate between macro and meso institutional environments? *Strategic Entrepreneurship Journal*, 8, 75-94; Kistruck, G.M., Webb, J.W. Sutter, C.J. & Bailey, A.V.G. (2015). The double-edged sword of legitimacy in base-of-the-pyramid markets. *Journal of Business Venturing*, 30(3), 436-51; Vu, T.T. (2014). Institutional Incongruence and the Informal Economy: An Empirical Analysis. Paper presented at the European Public Choice Society meeting, Cambridge; Webb, J.W., Bruton, G.D., Tihanyi, L. & Ireland, R.D. (2013). Research on entrepreneurship in the informal economy: framing a research agenda. *Journal of Business Venturing*, 28, 598-614.

## Rethinking the role of informal enterprise in economic development

For many years, informal enterprises have been widely portrayed as poorly performing endeavour relative to formal enterprises and thus as a hindrance to expanding the opportunities of the poor and deleterious to economic development and growth in the developing world. This poorer performance thesis prevails to varying extents across all theories of the informal economy. Firstly, modernization theory, or what La Porta and Schleifer term the “dual economy” perspective, views informal enterprises as hugely inefficient compared with formal enterprises, operating in different “bottom of the pyramid” markets and unlikely to be capable of charging lower prices for the same products.<sup>43</sup> Secondly, the structuralist approach, or what La Porta and Schleifer term the “parasitic” perspective, views the informal sector as a refuge where necessity-driven low-productivity firms, requiring low levels of start-up capital, stay small to avoid detection and lack the scale to produce efficiently, although the cost advantages gained by avoiding taxes and regulations more than offsets their low productivity and small scale.<sup>44</sup> Perhaps surprisingly, this poorer performance thesis also persists among scholars adopting more positive agency-oriented perspectives. The rational economic actor and social actor explanations, or what La Porta & Schleifer term the “romantic” perspective, depict informal enterprises as less productive than formal enterprises and as resulting from the general failure of “weak” institutions to provide sufficient resources to warrant formalization. Although viewed as less productive, there are nevertheless seen to be productivity-employment trade-offs, with informal enterprises viewed as creating jobs, albeit under-employment.<sup>45</sup>

To support this consensus that informal enterprises are worse performing than their formal counterparts, most scholars cite the seminal study by La Porta & Schleifer who find that “Productivity is much higher in small formal firms than in informal firms, and it rises rapidly with the size of formal firms”. However, this conclusion is reached by examining just 2,321 registered and 3,574 unregistered enterprises in 14 countries. More importantly, they explicitly state that the overall productivity gap disappears and “unregistered firms are not unusually unproductive once we take into account their expenditure on inputs, the human capital of their top managers, and their small size”.<sup>46</sup> Similar weak evidence exists in the few other studies of this poorer performance thesis.<sup>47</sup>

It is similarly argued that formal enterprises which started-up unregistered are poorly performing relative to enterprises registered from the outset. As La Porta and Schleifer assert, “the differences in productivity between formal and informal firms are so large that it is hard to believe that simply

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<sup>43</sup> La Porta, R. & Shleifer, A. (2008). The Unofficial Economy and Economic Development. *Brookings Papers on Economic Activity*, 47(1), 123-135; La Porta, R. & Shleifer, A. (2014). Informality and Development. *Journal of Economic Perspectives*, 28(3), 109-126.

<sup>44</sup> Farrell, D. (2004). The hidden dangers of informal economy. *McKinsey Quarterly*, 3, 27-37; Palmer, R. (2007). *Skills development, the enabling environment and informal micro-enterprise in Ghana*. Edinburgh: University of Edinburgh.

<sup>45</sup> De Soto, H. (1989), *The Other Path: the economic answer to terrorism*, London: Harper and Row; Kistruck, G.M., Webb, J.W. Sutter, C.J. & Bailey, A.V.G. (2015). The double-edged sword of legitimacy in base-of-the-pyramid markets. *Journal of Business Venturing*, 30(3), 436-51; Wunsch-Vincent, S., de Beer, J. & Fu, K. (2015). What we know and do not know about innovation in the informal economy. In E. Kraemer-Mbula & S. Wunsch-Vincent (Eds.), *The Informal Economy in Developing Nations: Hidden Engine of Innovation? new economic insights and policies* (pp. 142-60). Cambridge: Cambridge University Press.

<sup>46</sup> La Porta, R. & Shleifer, A. (2008). The Unofficial Economy and Economic Development. *Brookings Papers on Economic Activity*, 47(1), 123-135.

<sup>47</sup> Fajnzylber, P., Maloney, W. & Montes Rojas, G. (2009). Releasing constraints to growth or pushing on a string? policies and performance of Mexican micro-firms. *Journal of Development Studies*, 45, 1027-1047; Farrell, D. (2004). The hidden dangers of informal economy. *McKinsey Quarterly*, 3, 27-37; McKinsey Global Institute (2003). *Turkey: Making the Productivity and Growth Breakthrough*. New York: McKinsey.

registering unregistered firms would eliminate the gap.” Again however, the evidence is very limited. The only known study by Perry et al reports data on 355 unregistered start-ups across seven Latin American countries and finds that unregistered start-ups “at least initially, exhibit on average, much lower levels of output per worker, after controlling for firm size, time in business, sector and region”.<sup>48</sup> However, this is a small sample, the productivity gap is statistically significant in only four of the seven countries studied and the headline average national figure of 29% lower productivity for unregistered start-ups is heavily skewed by the Peru figure where the productivity gap is over 50%, is not statistically significant, and only 20 unregistered start-ups were surveyed.

Here, therefore, the impacts of starting-up unregistered and the length of time spent unregistered before registering on future firm performance are evaluated by reporting WBES data from 127 developing countries. Examining 95,522 formal private sector businesses with five or more employees surveyed in the WBES between 2006 and 2014, the intention is to evaluate whether formal enterprises which started-up unregistered have lower firm performance than those that were registered from the outset of their operations. To do this, a multi-level regression analysis of the relation between whether an enterprise started-up unregistered and length of nonregistration, and subsequent firm performance remain, when other key firm-level determinants of firm performance are introduced and held constant (e.g., firm size, firm age, technology and sector across countries), is conducted using random intercept and random slopes multilevel models.

The finding is that once other firm-level determinants of firm performance are controlled for, formal enterprises that started-up unregistered have an annual average sales growth rate 19.4% higher (i.e., 8.6% compared with 7.2%) than firms starting-up registered, an annual average employment growth rate 34.7% (i.e., 6.6% compared with 4.9%) higher than enterprises starting-up registered and that starting-up unregistered has no significant deleterious impact on their annual productivity growth rate, which is 0.09 percentage points lower than those registered from the outset.

Evaluating whether the longer start-ups spend unregistered before registering, the lower or higher is their future firm performance, the finding is that for each year a firm remains unregistered, annual sales growth rates are 0.149 percentage points higher and annual employment growth rates are 0.177 percentage points higher than for firms that started-up registered. However, there is no such premium from remaining unregistered for longer for annual productivity growth rates.

Comparing average annual sales growth for the average aged firm (17 years old), we find that it is 12% higher in those unregistered for six years rather than one year (8.3% compared with 7.4%), and for older firms (32 years old), 18% higher in those unregistered for six years rather than one year (4.5% and 5.3%). Examining average annual employment growth in the average age firm, this is 21% higher in those unregistered for six years rather than one year (6.2% compared with 5.1%) and for older firms, it is 47% higher in firms unregistered for six years rather than one year (2.8% and 1.9%). The suggestion, therefore, is that there is a long-lasting beneficial impact of remaining unregistered for longer, which is not only sustained but compounded over time as the firm ages.

These findings have important implications. They refute one of the core foundations of the negative representation of informal enterprises, namely that enterprises starting-up unregistered are poorer performing, and provide support for a more positive depiction of the informal sector as an incubator for future higher-performing enterprises. Moreover, the longer start-ups spend unregistered before registering, the better are their annual sales and employment growth rates, suggesting the need for a wider evaluation of the firm performance of informal compared with formal enterprises. Given the current weak evidence to support the poorer performance thesis of informal enterprises, and that similar to unregistered start-ups that later register, they operate under similar conditions that boost

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<sup>48</sup> Perry et al, 2007: 173



firm performance, including being able to avoid taxes, burdensome regulations and corrupt public sector officials, coupled with social legitimacy, strong rationales exist for examining whether firms continuously unregistered outperform formal enterprises. Finally, these findings provide a strong rationale for rigorously evaluating the many other assumptions regarding the negative and positive impacts of the informal economy so as to more fully test the currently commonly-held view that the overall net impact of the informal economy is negative.

## **POLICY OPTIONS**

Logically, there are four hypothetical policy choices available to policy-makers with regard to the informal economy. Policy-makers can either choose to: take no action; pursue the eradication of the informal economy; move formal work into the informal economy; or finally, transform the informal economy into the formal economy. Even if some of these hypothetical policy choices may appear to be a little far-fetched at first glance, commentators have advocated each and every one over recent decades. In consequence, one cannot reject any of these policy choices without evaluating their implications.

### **Take no action**

A first hypothetical policy option is for governments to take no action regarding the informal economy. Rationales for doing nothing about the informal economy might be that it is a seed-bed for new venture creation, a breeding ground for the micro-enterprise system and a test-bed for fledgling enterprises and should therefore no action should be taken.<sup>49</sup>

The problem with taking no action regarding the informal economy however, and as Table 7 summarised above, is that the informal economy has significant deleterious implications for formal businesses, informal enterprises and workers, customers and governments. Until now, no known rigorous evaluations have been conducted of the extent to which any of these supposed deleterious and beneficial impacts are in fact valid in practice. This is a significant gap that needs to be filled in future studies. Despite this lack of an evidence-base however, the strong consensus of both scholars and policy-makers is that on balance, the deleterious impacts outweigh the beneficial impacts of the informal economy. As such, the overwhelming consensus is that taking no action about the informal economy is not a feasible option. Interventions are thus seen to be required. What form of intervention, therefore, is needed?

### **Move formal work into the informal economy**

A second hypothetical policy option is to move formal work into the informal economy. Although this is not argued by any commentators since it is difficult to see what overall benefits would result, policy proposals have been made which in some respects voice the tenets of this approach. For example, commentators have advocated a de-regulation of the formal economy as a means of tackling the informal economy. This is based on the belief that the informal economy results from the over-regulation of the market, and the objective is thus to de-regulate the formal economy so that all

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<sup>49</sup> Williams, C.C. & Martinez-Perez, A. (2014a). Is the informal economy an incubator for new enterprise creation? a gender perspective. *International Journal of Entrepreneurial Behaviour and Research*, 20(1), 4-19; Williams, C.C. & Martinez-Perez, A. (2014b). Why do consumers purchase goods and services in the informal economy? *Journal of Business Research*, 67(5), 802-806.



activities are performed in a manner akin to what is currently the informal economy, although this would not be informal work because it would be conforming to the regulations that remain.<sup>50, 51, 52</sup>

However, problems exist with this policy approach. There is growing evidence that decreasing the level of state intervention in the economy does not result in a formalisation of informal work. Rather, the outcome is the inverse; greater levels of informal work.<sup>53</sup> Indeed, even if de-regulation were to lead to higher levels of formality, the outcome would appear to be a levelling down rather than up of working conditions.<sup>54</sup> In sum, even if de-regulation were to reduce the magnitude of the informal economy which by definition is a product of the regulations imposed on the formal economy, the impact would be probably to widen inequalities and a deterioration of working conditions.

### **Eradicate the informal economy**

Another interventionist option is to seek to eradicate the informal economy. If informal workers are viewed as 'rational economic actors' who will evade tax so long as the pay-off is greater than the expected cost of being caught and punished, their eradication can be achieved by changing the cost/benefit ratio confronting those engaged or thinking about participating in informal work.<sup>55</sup> This can be achieved by raising the costs of operating as an informal worker firstly, by increasing the perceived or actual likelihood of detection and secondly, the penalties and sanctions for doing so. In this 'negative reinforcement' approach therefore, the eradication of informal work is pursued through the use of 'sticks' to punish 'bad' (non-compliant) behaviour.

However, whether this is firstly, practical and secondly, desirable, is open to question. On the practical side, a key issue is whether this is effective. Although some studies reveal that improving detection and/or penalties reduces informal work, others identify that the informal economy grows and thus that 'it is not sensible to penalize illicit work with intensified controls and higher fines'.<sup>56</sup> This is because such a penalising approach can alienate informal workers, reducing their willingness to comply and increasing the extensiveness of the informal economy by reducing their belief in the fairness of the system.

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<sup>50</sup> Sauvy, A. (1984), *Le Travail Noir et l'Economie de Demain*, Paris: Calmann-Levy.

<sup>51</sup> De Soto, H. (1989), *The Other Path: the economic answer to terrorism*, London: Harper and Row.

<sup>52</sup> De Soto, H. (2001). *The Mystery of Capital: why capitalism triumphs in the West and fails everywhere else*. London: Black Swan.

<sup>53</sup> Kus, B. (2010), 'Regulatory governance and the informal economy: cross-national comparisons', *Socio-Economic Review*, 8(3), 487-510; Kus, B. (2014), 'The informal road to markets: neoliberal reforms, private entrepreneurship and the informal economy in Turkey', *International Journal of Social Economics*, 41(4), 278-93; <sup>53</sup> Williams, C.C. & Martinez-Perez, A. (2014a). Is the informal economy an incubator for new enterprise creation? a gender perspective. *International Journal of Entrepreneurial Behaviour and Research*, 20(1), 4-19; Williams, C.C. & Martinez-Perez, A. (2014b). Why do consumers purchase goods and services in the informal economy? *Journal of Business Research*, 67(5), 802-806

<sup>54</sup> Williams, C.C. & Martinez-Perez, A. (2014a). Is the informal economy an incubator for new enterprise creation? a gender perspective. *International Journal of Entrepreneurial Behaviour and Research*, 20(1), 4-19.

<sup>55</sup> Allingham, M. & Sandmo, A. (1972). Income tax evasion: a theoretical analysis. *Journal of Public Economics*, 1(2), 323-38.

<sup>56</sup> De Juan, A., M.A. Lasheras and R. Mayo (1994), 'Voluntary tax compliant behavior of Spanish income taxpayers', *Public Finance*, 49, 90-105; Slemrod, J., M. Blumenthal and C.W. Christian (2001), 'Taxpayer response to an increased probability of audit: evidence from a controlled experiment in Minnesota', *Journal of Public Economics*, 79, 455-83; Murphy, K. (2005), 'Regulating more effectively: the relationship between procedural justice, legitimacy and tax non-compliance', *Journal of Law and Society*, 32(4), 562-89.

It can also be questioned whether the eradication of the informal economy is desirable. If for example informal entrepreneurship is viewed as a breeding ground for the micro-enterprise system and a seedbed for enterprise culture, this informal realm is a potential asset that needs to be harnessed and a driver of economic development. Seeking its eradication will thus eliminate precisely the entrepreneurship and enterprise culture that governments are seeking to nurture. The resultant challenge for policy-makers is to 'join-up' their policy approach towards the informal economy with their agendas to nurture enterprise culture and entrepreneurship. Indeed, unless this is achieved, then governments with each new initiative to eradicate the informal economy will repress and destroy precisely the entrepreneurship and enterprise culture that they wish to nurture.

### **Transform informal work into formal work**

Rather than take no action, transfer formal work into the informal economy or stamp out the informal economy, a final logical option is to transform informal work into formal work.<sup>57</sup> The positive impacts of facilitating the formalisation of informal work vary according to whether formal and informal businesses, customers or the government, are considered.

So far as formal enterprises are concerned, transforming informal work into formal work would stop the unfair competitive advantage of informal businesses over those playing by the rules. It would also enable the business community to pursue a 'high road' rather than 'low road' approach by shifting towards greater regulatory standards on working conditions such as health and safety and labour standards. For informal workers meanwhile, the key benefits of legitimizing are manifold. They can escape the pressure to enter exploitative relationships with the legitimate realm and achieve the same levels of legal protection as formal workers.<sup>58</sup> Informal enterprises and entrepreneurs are also able to secure formal intellectual property rights for their products and processes and overcome the structural impediments which prevent them from expanding such as their lack of access to advice and support as well as capital.<sup>59</sup>

For customers, the advantages of legitimising informal work are that they benefit from legal recourse if a poor job is done, have access to insurance cover, enjoy guarantees with regard to the work conducted, and have more certainty that health and safety regulations are being followed.<sup>60</sup>

Finally, for governments, the benefits of transforming informal into formal work are that it improves the level of public revenue, thus enabling governments to pursue higher expenditure on social integration and mobility projects. It also enables the creation of more formal jobs and thus improves employment participation rates, and facilitates a joining-up of the policy approach towards informal

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<sup>57</sup> Dekker, H., E. Oranje, P. Renooy, F. Rosing and C.C. Williams (2010), *Joining up the Fight against Undeclared Work in the European Union*, Brussels: DG Employment, Social Affairs and Equal Opportunities; European Commission (2007), *Stepping up the Fight against Undeclared Work*, Brussels: European Commission;

<sup>58</sup> Gallin, D. (2001), 'Propositions on trade unions and informal employment in time of globalisation', *Antipode*, 19(4), 531-49; ILO (2014), *Transitioning from the informal to the formal economy*. Report V (1), International Labour Conference, 103rd Session (2014), Geneva: ILO; Morris, J. and A. Polese (2014), 'Introduction: informality – enduring practices, entwined livelihoods', in J. Morris and A. Polese (eds.), *The Informal Post-Socialist Economy: embedded practices and livelihoods*, London: Routledge, 1-18.

<sup>59</sup> De Beer, J., K. Fu and S. Wunsch-Vincent (2013), *The Informal Economy, Innovation and Intellectual Property: concepts, metrics and policy considerations*, Geneva: Economic Research Working Paper no. 10, World Intellectual Property Organization; ILO (2014), *Transitioning from the informal to the formal economy*. Report V (1), International Labour Conference, 103rd Session (2014), Geneva: ILO

<sup>60</sup> Williams, C.C. and Martinez-Perez, A. (2014c) "Entrepreneurship in the informal economy: a product of too much or too little state intervention?", *International Journal of Entrepreneurship and Innovation*, 15(4), 227–237.

work with the policy approaches towards entrepreneurship and social inclusion.<sup>61</sup> It also results in a more positive attitude towards the law more widely<sup>62</sup>

In sum, this review of the four hypothetical policy options available reveals that the first option of taking no action is unacceptable. This would leave intact the current negative impacts on formal businesses (e.g., unfair competition), informal workers (e.g., the inability to gain access to credit to expand), customers (e.g., no guarantee of health and safety standards) and governments (e.g., taxes owed are not collected). Secondly, transforming formal into informal work is unacceptable because it levels down rather than up of working conditions and third and finally, eradicating the informal economy is unacceptable since it results in governments repressing and eradicating precisely the entrepreneurial endeavour and enterprise culture that they otherwise wish to foster. Transforming informal work into formal work thus appears to be the most viable policy choice. How, therefore, can this be achieved?

## POLICY APPROACHES AND MEASURES

To harness this endeavour, a first potential way forward is to reduce the costs and improve the benefits of formalization. Indeed, the case study of how enterprises unregistered at start-up and remaining unregistered longer outperform those registered from the outset reveal that the benefits of formalization currently remain insufficient to outweigh the benefits of informality in developing countries. Studies of how simplifying and reducing the cost of formalization result in an increase in registration for example, have been reported in Kenya (Sri Lanka) find that even a financial offer equivalent to two months' profits led to only 50% of firms registering.<sup>63</sup> This has been explained as due to the benefits of formalization not being high enough to be an incentive to formalize, the limited ambitions of entrepreneurs, mistrust in governments and fear of the high recurrent costs of formalization.<sup>64</sup>

However, reducing the costs and improving the benefits of formalization is not the only means of harnessing this sphere. It assumes that informal workers are purely rational economic actors. In recent years, recognition has emerged, grounded in institutional theory, that informal workers are also often

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<sup>61</sup> Dekker, H., E. Oranje, P. Renooy, F. Rosing and C.C. Williams (2010), *Joining up the Fight against Undeclared Work in the European Union*, Brussels: DG Employment, Social Affairs and Equal Opportunities; European Commission (2007), *Stepping up the Fight against Undeclared Work*, Brussels: European Commission; Small Business Council (2004), *Small Business in the Informal Economy: making the transition to the formal economy*, London: Small Business Council.

<sup>62</sup> Polese, A. (2014), 'Drinking with Vova: an individual entrepreneur between illegality and informality', in J. Morris and A. Polese (eds.), *The Informal Post-Socialist Economy: embedded practices and livelihoods*, London: Routledge, 85-101; Sasunkevich, O. (2014), 'Business as casual: shuttle trade on the Belarus-Lithuania border', in J. Morris and A. Polese (eds.), *The Informal Post-Socialist Economy: embedded practices and livelihoods*, London: Routledge, 135-51.

<sup>63</sup> Devas, N., & Kelly, R. (2001). Regulation or revenue? An analysis of local business licenses, with a case study of the single business permit reform in Kenya. *Public Administration and Development*, 21, 381–191; Sander, C. (2003). *Less is more: Better compliance and increased revenues by streamlining business registration in Uganda: a contribution to WDR 2005 on investment climate, growth and poverty*. London: Department for International Development; Garcia-Bolivar, O. (2006). *Informal economy: Is it a problem, a solution or both? The perspective of the informal business*. Berkeley, CA: Bepress Legal Series; Jaramillo, M. (2009). *Is there demand for formality among informal firms? Evidence from microfirms in downtown Lima*. Bonn: German Development Institute Discussion Paper 12/2009, German Development Institute; De Mel, S., McKenzie, D., & Woodruff, C. (2012). *The demand for, and consequences of formalization among informal firms in Sri Lanka*. Washington DC: Policy Research Working Paper 5991, World Bank.

<sup>64</sup> Maloney, W.F. (2004). Informality revisited. *World Development*, 32(7), 1159-78; McKenzie, D. & Woodruff, C. (2006). Do entry costs provide an empirical basis for poverty traps? Evidence from microenterprises. *Economic Development and Cultural Change* 55(1), 3-42

social actors.<sup>65</sup> Based on this view that informal work arises when citizens' norms, values and beliefs are not in symmetry with the prescriptions of formal institutions, consideration also needs to be given to better aligning citizens' norms, values and beliefs with the formal institutions as a means of facilitating the formalisation of this sphere. On the one hand, this requires measures to alter norms, values and beliefs regarding the acceptability of operating informally so that institutional asymmetry (and thus informal work) is reduced, such as by raising awareness about the benefits of taxation and the public goods received. On the other hand, this re-alignment also requires alterations in formal institutions. These are of two types. Firstly, improvements are needed in the processes of formal institutions in terms of tax fairness, procedural justice and redistributive justice. Fairness here refers to the extent to which entrepreneurs believe they are paying their fair share compared with others, redistributive justice to whether they receive the goods and services they feel that they deserve given the taxes that they pay and procedural justice to the degree to which they believe that the tax authority has treated them in a respectful, impartial and responsible manner.<sup>66</sup> Secondly, improvements are also required in formal institutions to provide incentives for formalization. In recent years, institutional theorists have shown how informal work declines as for example the quality of governance improves and public sector corruption decreases, and the level of government intervention increases.<sup>67</sup> Indeed, the analysis in section 3.2 reinforced and extended these findings, revealing that the degree and intensity of informalisation is lower in modernised economies, with lower levels of public sector corruption, higher tax rates, greater levels of social protection expenditure and lower levels of poverty. Tackling employment in the informal economy, therefore, requires wider policy measures to incentivize formalisation, including the wider issues of tackling under-development, public sector corruption and poverty through increasing tax rates and social protection expenditure.

These different policy measures to harness this sphere based on rational economic actor and social actor approaches, however, are not mutually exclusive. Indeed, there are at least two ways of combining them. Firstly, a "responsive regulation" approach starts out by openly engaging citizens to self-regulate themselves in a manner consistent with the law. This facilitating of voluntary compliance is then followed by persuasion through incentives and only as a last resort for the small minority

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<sup>65</sup> De Castro J.O., Khavul, S. & Bruton, G.D. (2014). Shades of grey: how do informal firms navigate between macro and meso institutional environments? *Strategic Entrepreneurship Journal*, 8, 75-94; Webb, J.W., Tihanyi, L., Ireland, R.D. & Sirmon, D.G. (2009). You say illegal, I say legitimate: entrepreneurship in the informal economy. *Academy of Management Review*, 34(3), 492-510; Webb, J.W., Bruton, G.D., Tihanyi, L. & Ireland, R.D. (2013). Research on entrepreneurship in the informal economy: framing a research agenda. *Journal of Business Venturing*, 28, 598-614; Webb, J.W., Ireland, R.D. & Ketchen D.J. (2014). Towards a greater understanding of entrepreneurship and strategy in the informal economy. *Strategic Entrepreneurship Journal*, 8(1), 1-15; Williams, C.C. & Shahid, M. (2015). Informal entrepreneurship and institutional theory: explaining the varying degrees of (in)formalisation of entrepreneurs in Pakistan. *Entrepreneurship and Regional Development*, <http://dx.doi.org/10.1080/08985626.2014.963889>

<sup>66</sup> Wenzel, M. (2004). An analysis of norm processes in tax compliance. *Journal of Economic Psychology*, 25(2), 213-228; Braithwaite, V. & Reinhart, M. (2000). *The Taxpayers' Charter: does the Australian Tax Office comply and who benefits*. Canberra: Centre for Tax System Integrity Working Paper no.1, Australian National University; Murphy, K. (2005), 'Regulating more effectively: the relationship between procedural justice, legitimacy and tax non-compliance', *Journal of Law and Society*, 32(4), 562-89

<sup>67</sup> Autio, E. & Fu, K. (2015). Economic and political institutions and entry into formal and informal entrepreneurship. *Asia Pacific Journal of Management*, 32(1), 67-94; Dau, L.A. and Cuervo-Cazurra, A. (2014). To formalize or not to formalize: entrepreneurship and pro-market institutions. *Journal of Business Venturing*, 29, 668-86; Klapper, L., Amit, R., Guillen, M.F. & Quesdada, J-M. (2007). *Entrepreneurship and Firm Formation across Countries*. Washington DC: Policy Research Working Paper series 4313, World Bank; Thai, M.T.T. & Turkina, E. (2014). Macro-level determinants of formal entrepreneurship versus informal entrepreneurship. *Journal of Business Venturing*, 29(4), 490-510.

refusing to be compliant does it use punitive measures.<sup>68</sup> A second approach is the “slippery slope framework” which pursues both voluntary and enforced compliance concurrently by developing both greater trust in authorities and the greater power of authorities.<sup>69</sup> Until now however, there has been little comparative evaluation of which sequencing and/or combination is the most appropriate and/or effective means of harnessing this sphere.

This, therefore, is a major topic for future policy research on the informal economy. Moreover, and given the persistent widespread assumption that the informal economy is on the whole a negative phenomenon that is deleterious to economic development and growth and does not tackle poverty, but the lack of an evidence-base to support this, a comprehensive evaluation is required of the various purported negative and positive impacts of the informal economy. Indeed, until such an evidence-based evaluation is conducted, it cannot be known whether the informal economy has a net positive or negative impact on expanding the opportunities of the poor. What is for certain, however, is that the dominant policy approach of eradicating the informal economy can no longer be simply assumed to be the way forward. Not only is a wider consideration required of the potential positive impacts of this sphere on expanding opportunities of the poor required but also more creative policy approaches towards how this sphere may be harnessed to that end.

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<sup>68</sup> Braithwaite V. (2009), *Defiance in Taxation and Governance: resisting and dismissing authority in a democracy*, Cheltenham: Edward Elgar; Job, J., Stout, A. & Smith, R. (2007). Culture change in three taxation administrations: from command and control to responsive regulation. *Law and Policy*, 29(1), 84-101

<sup>69</sup> Kirchler, E., Hoelzl, E. & Wahl, I. (2008). Enforced versus voluntary tax compliance: the ‘slippery slope’ framework. *Journal of Economic Psychology*, 29, 210–25; Kogler, C., Muelbacher, S. & Kirchler, E. (2015). Testing the “slippery slope framework” among self-employed taxpayers. *Economics of Governance*, doi: 10.1007/s10101-015-0158-9; Muehlbacher, S., Kirchler, E. & Schwarzenberger, H. (2011). Voluntary versus enforced tax compliance: empirical evidence for the “slippery slope” framework. *European Journal of Law and Economics*, 32(1), 89–97; Wahl, I., Kastlunger, B. & Kirchler, E. (2010). Trust in authorities and power to enforce tax compliance: an empirical analysis of the “slippery slope framework”. *Law and Policy*, 32, 383–406.